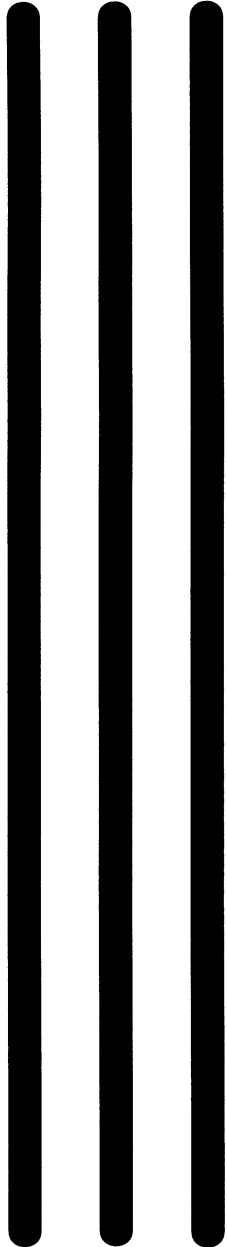




**U. S. Department of Agriculture  
Office of Inspector General  
Audit Report**



**Rural Development's  
Consolidated Financial  
Statements for  
Fiscal Year 1998**

**Audit Report No.  
50401-28-FM  
January 1999**





UNITED STATES DEPARTMENT OF AGRICULTURE  
OFFICE OF INSPECTOR GENERAL  
Washington D.C. 20250



DATE: February 1, 1999

REPLY TO  
ATTN OF: 50401-28-FM

SUBJECT: Rural Development's Consolidated  
Financial Statements for Fiscal Year 1998

TO: Jill Long Thompson  
Under Secretary  
Rural Development

ATTN: Sherie Hinton Henry  
Director  
Financial Management Division

This report presents the results of our audit of the Rural Development consolidated financial statements for the fiscal year (FY) ended September 30, 1998. The report contains our qualified opinion on the FY 1998 consolidated statements and the results of our assessment of Rural Development's internal control structure and compliance with laws and regulations.

In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing the corrective action taken or planned, including the timeframes, on our recommendations. Please note that the regulation requires a management decision to be reached on all findings and recommendations within a maximum of 6 months from report issuance.

We appreciate the courtesies and cooperation extended to us during the audit.

ROGER C. VIADERO  
Inspector General

---

# EXECUTIVE SUMMARY

## U.S. DEPARTMENT OF AGRICULTURE RURAL DEVELOPMENT'S CONSOLIDATED FINANCIAL STATEMENTS FOR FISCAL YEAR 1998 AUDIT REPORT NO. 50401-28-FM

---

---

### PURPOSE

---

Our audit objectives were to determine whether (1) the financial statements present fairly, in all material respects, in accordance with Federal accounting standards, the assets, liabilities, and net position; net costs; changes in net position; budgetary resources; and reconciliation of net costs to budgetary obligations, (2) the internal control structure provides reasonable assurance that the internal control objectives were met, and (3) Rural Development complied with laws and regulations for those transactions and events that could have a material effect on the financial statements.

---

### RESULTS IN BRIEF

---

Our report discusses our qualified opinion on Rural Development's financial statements. Our longstanding qualification is due to Rural Development's inability to adequately substantiate the value of the Government's investment in its outstanding direct and guaranteed loans. We have reported this serious problem since fiscal year (FY) 1992. Rural Development is currently scheduled to correct this problem by FY 1999. However, unless further substantial actions are taken, we believe this target will not be met.

Our report on Rural Development's internal control structure discusses weaknesses in the mission area's support for estimating and reestimating loan subsidy costs; improvements needed in Rural Development's information technology security and controls; and Rural Development's oversight of its guaranteed rural housing loans.

During FY 1998, the Centralized Servicing Center (CSC) and Chief Financial Officer (CFO) contracted with a Certified Public Accounting (CPA) firm to perform a vulnerability assessment of CSC

operations. The CPA firm reported control weaknesses in procedures for balancing transactions to the general ledger, reviewing general ledger entries, receipt of checks, administrative adjustments, unapplied funds, and escrow transactions. Actions taken by the CSC and CFO resolved all problems during FY 1998, except for the review of general ledger entries, and processing of unapplied funds.

Our compliance report describes Rural Development's noncompliance with Federal financial management systems requirements under the Federal Financial Management Improvement Act, as well as noncompliance with certain aspects of the Debt Collection Improvement Act and Office of Management and Budget Circular A-129.

---

## KEY RECOMMENDATIONS

---

**W**e recommended that Rural Development improve its oversight of rural housing guaranteed loans. We further recommended that Rural Development maximize the usage of tools for preventing delinquent debtors from receiving future Federal assistance. Additionally, we recommended that repurchased guaranteed loans and defaulted guaranteed loans be reported to the Treasury Offset Program. We will address recommendations on credit reform in our Audit Report No. 50401-30-FM.

---

## AGENCY POSITION

---

**W**e discussed the findings and recommendations contained herein with Rural Development and are working with Rural Development to implement the report recommendations.

Rural Development advised us that preparation of the Statement of Financing was a challenge for many Federal agencies; and improvement is needed in governmentwide standard general ledger crosswalks used to prepare the Statement of Financing.

---

# TABLE OF CONTENTS

---

EXECUTIVE SUMMARY ..... i

---

REPORT OF THE OFFICE OF INSPECTOR GENERAL ..... 1

---

REPORT OF THE OFFICE OF INSPECTOR GENERAL  
ON INTERNAL CONTROL STRUCTURE ..... 4

FINDINGS AND RECOMMENDATIONS ..... 7

I. MORE MUST BE DONE TO RESOLVE LONGSTANDING PROBLEMS WITH  
RURAL DEVELOPMENT'S CREDIT REFORM ACCOUNTING ..... 7

II. IMPROVEMENTS STILL NEEDED IN INFORMATION TECHNOLOGY  
SECURITY AND CONTROLS ..... 9

III. CONTROLS OVER TRANSACTIONS PROCESSED AT THE  
CENTRALIZED SERVICING CENTER (CSC) WERE IMPROVED  
DURING FY 1998 ..... 11

IV. OVERSIGHT OF RURAL HOUSING GUARANTEED LOANS NEEDS  
IMPROVEMENT ..... 13

RECOMMENDATION NO. 1 ..... 14

---

REPORT OF THE OFFICE OF INSPECTOR GENERAL  
ON COMPLIANCE WITH LAWS AND REGULATIONS ..... 15

---

# TABLE OF CONTENTS

---

<b>FINDINGS AND RECOMMENDATIONS</b> .....	17
<b>I. FINANCIAL MANAGEMENT SYSTEMS NEED         SUBSTANTIAL IMPROVEMENT</b> .....	17
<b>II. DEBT COLLECTION NEEDS STRENGTHENING</b> .....	20
<b>RECOMMENDATION NO. 2</b> .....	21

---

<b>EXHIBIT A: ABBREVIATIONS</b> .....	22
---------------------------------------	----

---

## **RURAL DEVELOPMENT CONSOLIDATED FINANCIAL STATEMENTS FISCAL YEAR 1998 (Prepared by Rural Development)**

<b>OVERVIEW OF RURAL DEVELOPMENT         CONSOLIDATED STATEMENTS</b> .....	1
<b>CONSOLIDATED BALANCE SHEET</b> .....	12
<b>CONSOLIDATING STATEMENT OF NET COST</b> .....	15
<b>CONSOLIDATING STATEMENT OF CHANGES IN NET POSITION</b> .....	17
<b>CONSOLIDATED STATEMENT OF BUDGETARY RESOURCES</b> .....	19
<b>CONSOLIDATED STATEMENT OF FINANCING</b> .....	20
<b>NOTES TO CONSOLIDATED FINANCIAL STATEMENTS</b> .....	21
<b>REQUIRED SUPPLEMENTARY INFORMATION</b> .....	59



---

## REPORT OF THE OFFICE OF INSPECTOR GENERAL

---

**TO:** Jill Long Thompson  
Under Secretary  
Rural Development

**W**e have audited the accompanying Consolidated Balance Sheet of Rural Development, a mission area of the United States Department of Agriculture (USDA), as of September 30, 1998, and the related Consolidated Statements of Net Cost, Changes in Net Position, Budgetary Resources, and Financing for the fiscal year (FY) then ended. These financial statements are the responsibility of Rural Development's management. Our responsibility is to express an opinion on these financial statements based on our audit.

Except as discussed below, we conducted our audit in accordance with Government Auditing Standards issued by the Comptroller General of the United States, and the Office of Management and Budget (OMB) Bulletin 98-08, "Audit Requirements for Federal Financial Statements," and other OMB bulletins applicable to the period under audit. 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 significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

We were unable to obtain sufficient and competent evidential matter to support Rural Development's credit program receivables and estimated losses on loan guarantees stated at about \$54.9 billion and \$460 million, respectively, at September 30, 1998, and the related financial statement line items shown below:

- Balance Sheet: Unexpended Appropriations and Cumulative Results of Operations.
- Statement of Net Cost: Grants and Transfers.

- Statement of Changes in Net Position: Appropriations Used, Recovery of Appropriations Used, Transfers-Out, and Increase (Decrease) in Unexpended Appropriations.
- Statement of Budgetary Resources: Unobligated Balances-Beginning of Period, Unobligated Balances - Available, and Unobligated Balances - Not Available.

Furthermore, we were unable to obtain sufficient and competent evidential matter to support Rural Development's Statement of Financing. The Statement of Financing is impacted by the lack of support for credit program receivables and estimated losses on loan guarantees described above. Additionally, Rural Development is unable to support two of the line items in the section entitled Resources Used to Fund Items Not Part of the Net Cost of Operations. Because of conditions noted, we determined that it was not practicable to perform further alternate procedures to satisfy ourselves as to: (1) the value of any of the financial statement line items on the Statement of Financing and (2) the value of the assets, liabilities, equity, costs, financing sources, and budgetary resources relating to credit reform.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to assess the reasonableness of the Statement of Financing and all financial statement line items impacted by credit program receivables and estimated loss on loan guarantees, and the related credit reform program subsidy, the financial statements referred to above, including the accompanying notes, present fairly, in all material respects, in conformity with Federal accounting standards, the assets, liabilities, and net position of Rural Development as of September 30, 1998; as well as its net costs, changes in net position, and budgetary resources for the fiscal year then ended.

As discussed in the notes to the financial statements, Rural Development implemented Statement of Federal Financial Accounting Standards Nos. 6, 7 and 8 which became effective for fiscal years beginning after September 30, 1997.

Our audit was conducted for the purpose of forming an opinion on Rural Development's financial statements taken as a whole. The information in the Overview and Required Supplementary Information sections represent supplementary information required by OMB Bulletin 97-01, "Form and Content of Agency Financial Statements." We have considered whether this information is materially inconsistent with the principal financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements and accordingly, we express no opinion on it.

We have also issued a report on Rural Development's internal controls which cites two material internal control weaknesses and a report on the mission area's compliance with laws and regulations which cites two material instances of noncompliance with laws and regulations.



This report is intended for the information of the management of Rural Development, OMB and Congress. However, this report is a matter of public record and its distribution is not limited.

ROGER C. VIADERO  
Inspector General

January 5, 1999



---

## REPORT OF THE OFFICE OF INSPECTOR GENERAL ON INTERNAL CONTROL STRUCTURE

---

**TO:** Jill Long Thompson  
Under Secretary  
Rural Development

**W**e have audited the accompanying consolidated financial statements of Rural Development for the fiscal year ended September 30, 1998, and have issued our report thereon, dated January 5, 1999. Except as discussed in our opinion, we conducted our audit in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and OMB Bulletin 98-08, "Audit Requirements for Federal Financial Statements," and other OMB bulletins applicable for the period under audit.

In planning and performing our audit, we considered Rural Development's internal control over financial reporting by obtaining an understanding of Rural Development's internal controls, determined whether these internal controls had been placed in operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Consequently, we do not provide an opinion on internal controls.

In addition, with respect to internal controls related to performance measures reported in the Overview section, we obtained an understanding of the design of significant controls relating to the existence and completion assertions, as required by OMB Bulletin 98-08. Our procedures were not designed to provide assurance on internal controls over reported performance measures, and accordingly, we do not provide an opinion on such internal controls.

### **MANAGEMENT'S RESPONSIBILITY FOR INTERNAL CONTROL STRUCTURE**

**T**he management of Rural Development is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures.

The objectives of an internal control structure are to provide management reasonable, but not absolute assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with the agency's prescribed basis of accounting. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In its FY 1998 Federal Managers' Financial Integrity Act (FMFIA) report, Rural Development reported to the Secretary of Agriculture that it generally complied with Section 2, Management Accountability and Control. Rural Development identified three material internal control weaknesses that included: (1) Oversight of automation modernization, including security, (2) controls for establishing and reestimating loan subsidy costs, and (3) revision of regulations impacting the Multi-Family Housing program to minimize abuse by participants. Additionally, in its FY 1998 FMFIA report, Rural Development reported that it was not in compliance with Section 4, Financial Management Systems, because of identified weaknesses in financial accounting systems. The FMFIA report discusses four material nonconformances in Rural Development's financial management systems. These nonconformances occurred in the guaranteed loan servicing and reporting subsystems and the direct loan servicing and reporting subsystems.

## **OIG'S EVALUATION OF RURAL DEVELOPMENT'S INTERNAL CONTROL STRUCTURE**

**F**or the purpose of this report, we have classified Rural Development's significant internal control structure policies and procedures into the following categories.

- Grants and Credit Program Receivables - consists of policies and procedures associated with authorizing and disbursing loans and grants, and collecting loan repayments.
- Guaranteed Loans - consists of policies and procedures associated with authorizing and disbursing payments, authorizing guarantees, and collecting repayments on defaulted guaranteed loans.
- Interest and Allowance for Credit Program Receivable - consists of policies and procedures associated with accruing interest and interest income and determining the allowance for subsidy and liability for loan guarantees.

- Treasury - consists of policies and procedures associated with disbursing and collecting cash, reconciling cash balances, and managing debt.
- Financial Reporting - consists of policies and procedures associated with processing accounting entries and preparing Rural Development's annual financial statements.

In each of the internal control structure categories previously listed, we obtained an understanding of the design of significant control policies and procedures and whether they have been placed in operation. We assessed control risk and performed tests of Rural Development's internal control structure.

In making our risk assessment, we considered Rural Development's FMFIA reports as well as our prior and current audit efforts and other independent auditor reports on financial matters and internal accounting control policies and procedures. Regarding the 1998 FMFIA report, we agree with Rural Development's conclusions that it generally complied with Section 2 and was in noncompliance with Section 4.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of internal control that, in our judgement, could adversely affect the agency's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Matters involving internal control and its operation that we consider to be reportable conditions are presented in the "Findings and Recommendations" section of this report.

---

## FINDINGS AND RECOMMENDATIONS

---

### I. MORE MUST BE DONE TO RESOLVE LONGSTANDING PROBLEMS WITH RURAL DEVELOPMENT'S CREDIT REFORM ACCOUNTING

---

#### FINDING NO. 1

---

**W**e have reported weaknesses in the processes and procedures used by Rural Development to estimate and reestimate loan subsidy costs since 1992. Despite several plans spanning about 3 years, these material weaknesses continue to exist. As a result, we are unable to assess the reasonableness of Rural

Development's credit program receivables and estimated losses on loan guarantees, stated at about \$54.9 billion and \$460 million respectively.

Effective for FY 1992, the Federal Credit Reform Act (Act) of 1990 required the President's Budget to reflect the "costs" of direct loan and guarantee programs. "Costs" are defined by this Act to mean the estimated long-term cost to the Government of direct loans or loan guarantees, calculated on a net present value basis, excluding administrative costs and incidental effects of receipts and outlays.

Rural Development has been unable to reasonably estimate the "costs" of its loan programs because its financial management systems are not appropriately configured to capture the necessary data to make reasonable estimates. Rural Development has acknowledged that improvements are needed in the processes and procedures used to establish and reestimate loan subsidy costs. Rural Development indicated in its FY 1998 FMFIA report that lack of staff, and lack of staff trained on credit reform, as well as unforeseen obstacles have caused the planned date to correct this weakness to change from FY 1998 to the end of FY 1999.

Rural Development's "Cash Flows and Reestimate Workplan," dated July 22, 1998, provides its most current corrective actions and planned completion dates to resolve this material weakness. Key corrective actions include the development of three simplified cash

flow models for (1) non-housing direct programs, (2) direct housing programs, and (3) guaranteed programs. During FY 1998, Rural Development worked to develop cash flow information for non-housing programs. The final targeted completion date is currently shown as September 30, 1999. However, as of December 1998, Rural Development continues to refine and develop the models. The Office of Inspector General (OIG) has initiated a comprehensive audit of overall Department credit reform problems, and will provide additional formal recommendations in several months.

OIG believes that for Rural Development to resolve these problems, within the timeframes established by the Department to fix this longstanding problem, Rural Development needs additional contractor resources in order to perform the required analysis, and identify and review sources of data, some of which may need to be developed. Rural Development is further impacted by the many dissimilar loan programs which disburse over multiple years and/or provide for various payment assistance for borrowers, making the development of appropriate cash flow models extremely complex. Economic, statistical, and mathematical assumptions will all need consideration in order to ensure the validity of the cash flow models.

OIG discussed longstanding departmental credit reform issues, including those of Rural Development, in its report on the USDA's Consolidated Financial Statements for Fiscal Year 1997, Audit Report No. 50401-24-FM. We recommended in that report that the Department develop a comprehensive plan to resolve all outstanding credit reform issues by FY 1999; and in order to do so that subcabinet officials assume the responsibility for corrective actions.

Because credit reform continues to be a material problem departmentwide, recommendations will be made in Audit Report No. 50401-30-FM, "Fiscal Year 1998 USDA Consolidated Financial Statements."

## II. IMPROVEMENTS STILL NEEDED IN INFORMATION TECHNOLOGY SECURITY AND CONTROLS

### FINDING NO. 2

As noted in our prior audit report (50401-21-FM, May 1998), the Rural Development Information Technology security program needed strengthening. During FY 1998, Rural Development developed corrective action plans to address the problem areas. The status of these include:

- Rural Development has not certified its financial management systems in compliance with OMB Circular A-130, "Management of Federal Information Resources." Circular A-130 requires certification/recertification reviews, which provide assurances that systems have adequate security to prevent misuse or unauthorized access to or modification of information. Rural Development will develop a plan by March 31, 1999, to complete certification and recertification of major applications and general support systems over a 3-year cycle. Rural Development plans to complete the certification/recertification of systems by December 31, 2001.
- Rural Development has not implemented a "firewall system" to provide security over Internet telecommunications, leaving much of the Local Area Network/Wide Area Network open to intrusion from unauthorized sources through the Internet. Rural Development has evaluated and selected firewall software for the Internet Service Provider at St. Louis, Missouri, in accordance with the Department's Office of Chief Information Officer guidelines. The firewall software will be installed by April 30, 1999.
- Disaster recovery and contingency plans, which assist in the continuity of operations, are not up-to-date and did not exist for all Rural Development facilities. During FY 1999, Rural Development is taking the necessary actions to update the disaster recovery and contingency plans.

Additionally, during FY 1998 OIG reviewed Rural Development's Year 2000 conversion efforts. OIG issued a management alert under Audit No. 50099-17-FM, dated October 15, 1998, to the USDA Chief Information Officer which covered our reviews at several agencies, including Rural Development. For Rural Development, the management

alert included issues relating to the reporting of Year 2000 compliant systems to OMB, as well as the need for project tracking and cost reporting systems.

We have made recommendations to the Department's Chief Information Officer (CIO) to resolve these issues departmentwide. The CIO has taken action to address our concerns by directing agencies to:

- Obtain any needed Executive Sponsor certification of systems identified as compliant, and
- identify and capture actual Year 2000 conversion costs, to the extent possible, in order to support the total estimated costs reported to OMB.

Rural Development officials advised us that they have addressed the above recommendations.



### III. CONTROLS OVER TRANSACTIONS PROCESSED AT THE CENTRALIZED SERVICING CENTER (CSC) WERE IMPROVED DURING FY 1998

#### FINDING NO. 3

Control weaknesses existed over transactions processed at the CSC<sup>1</sup> for most of FY 1998. CSC processed transactions for over 632,000 single family housing loans valued at over \$17 billion. While these weaknesses were substantially corrected by the end of the fiscal year, the weaknesses reduce the reliability of data related to these

transactions included in the financial statements for FY 1998.

During FY 1997, Rural Development converted approximately 650,000 single family housing accounts to the new Dedicated Loan Origination and Servicing (DLOS) System. In order to ensure that appropriate internal controls were in place at CSC, Rural Development's Chief Financial Officer (CFO) contracted for an independent vulnerability assessment. The vulnerability assessment was conducted from March 31 to June 5, 1998. The vulnerability assessment reported the following weaknesses in the control environment surrounding the processing and reporting of DLOS transactions:

- Although CSC was performing daily balancing of transactions within the DLOS System, policies and procedures were not in place to balance DLOS detailed transactions and balances on a daily or cumulative basis to the Rural Development general ledger. CFO employees began balancing to the general ledger on July 1, 1998. Corrective actions for balancing procedures were completed on August 31, 1998.
- Review of the DLOS table that maps DLOS transactions to the appropriate general ledger accounts was not adequate. Transaction reviews were still ongoing at fiscal yearend.

---

<sup>1</sup>The CSC was created by Rural Housing Service (RHS) to consolidate multiple loan-servicing functions previously performed at over 1,200 field offices around the United States. The CSC provides servicing for home purchase and rehabilitation mortgages to rural, low-income borrowers using a customized commercial software package.

- Borrower payments and checks from the field were received in the mailroom and forwarded to the Cash Management Branch without being logged. CSC established a wholesale lockbox to receive these payments effective August 3, 1998. Controls over checks that bypass the lockbox were completed November 18, 1998.
- Procedures for posting administrative adjustments to borrower files were not consistent between branches, and did not include adequate approvals. New CSC-wide procedures, which included adequate approvals, were implemented August 5, 1998.
- The DLOS System did not apply overpayments to customer accounts. Overpayments were credited to an unapplied receivable, and then were manually applied to principal, interest, and/or escrow. An automated process was implemented in December 1998.
- General ledger records for escrow transactions were not maintained. A subsidiary trial balance for escrow was established during FY 1998 and was completed by fiscal yearend.

Due to planned or completed corrective actions on these items, we are making no recommendations in this report.

## IV. OVERSIGHT OF RURAL HOUSING GUARANTEED LOANS NEEDS IMPROVEMENT

### FINDING NO. 4

Rural Development needs to improve its oversight of the rural housing guaranteed loan program to ensure that the Government's interests are adequately protected. We found that the frequency and timeliness of lender reporting to Rural Development needed improvement to ensure effective management of guaranteed loan programs. As a result, Rural

Development has diminished oversight over this \$7 billion program.

The guaranteed single family housing loan program was established in FY 1991 as a pilot project with a small appropriation. Since then, the loan activity and associated losses have increased dramatically. As of September 30, 1998, guaranteed single family housing loans numbered over 110,000; with unpaid principal of over \$7 billion. Rural Development anticipates that the program will continue its rapid growth.

OMB Circular A-129, "Policies for Federal Credit Programs and Non-Tax Receivables," requires agencies to obtain data relating to loan activity and status from lenders quarterly. The Circular points out that credit agencies require this type of information to monitor the health of their guaranteed loan portfolio, track and evaluate lender performance, and satisfy OMB, Treasury and other reporting requirements. Although its guaranteed single family housing borrowers make monthly payments, agency regulations require only annual reporting to Rural Development. Rural Development indicated that more frequent reporting is desirable, but the resources needed to process the status reports, etc., needs to be considered.

During our audit, we reviewed the followup actions taken at servicing offices with lenders who have not returned the annual status report to Rural Development. We found that lenders do not always submit annual reports timely, and followup by the responsible servicing office needed improvement. Of approximately 85,000 status requests mailed by Rural Development to lenders in December 1997, lenders had not responded to over 23,000 requests by September 30, 1998.

---

## RECOMMENDATION NO. 1

---

Ensure that lender status reports are obtained at least quarterly. Require servicing offices to promptly followup with lenders who do not submit the status reports as required.

Material weaknesses are reportable conditions in which the design or operation of one or more internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We believe the reportable conditions described in Findings Nos. 1 and 2 are material weaknesses.

This report is intended for the information of the management of Rural Development, OMB and Congress. However, this report is a matter of public record and its distribution is not limited.

ROGER C. VIADERO  
Inspector General

January 5, 1999



UNITED STATES DEPARTMENT OF AGRICULTURE  
OFFICE OF INSPECTOR GENERAL  
Washington D.C. 20250



---

## REPORT OF THE OFFICE OF INSPECTOR GENERAL ON COMPLIANCE WITH LAWS AND REGULATIONS

---

**TO:** Jill Long Thompson  
Under Secretary  
Rural Development

**W**e have audited the consolidated financial statements of Rural Development for the fiscal year ended September 30, 1998, and have issued our report thereon, dated January 5, 1999. Except as discussed in our opinion, we conducted our audit in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in the Government Auditing Standards, issued by the Comptroller General of the United States, and OMB Bulletin 98-08, "Audit Requirements for Federal Financial Statements" as well as other OMB bulletins applicable for the period under audit. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The management of Rural Development is responsible for compliance with laws and regulations applicable to it. As part of obtaining reasonable assurance about whether Rural Development's consolidated financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts and certain other laws and regulations specified in OMB Bulletin 98-08. We tested compliance with:

- Agricultural Credit Improvement Act of 1992;
- Agriculture Credit Act of 1987;
- Anti-Deficiency Acts of 1906 and 1950;
- Budget and Accounting Procedures Act of 1950;
- Chief Financial Officers Act of 1990;
- Consolidated Farm and Rural Development Act of 1961, as amended;
- Debt Collection Improvement Act of 1996 (DCIA)
- Federal Agriculture Improvement and Reform Act of 1996;
- Federal Credit Reform Act of 1990;
- Federal Financial Management Improvement Act of 1996 (FFMIA);
- Federal Managers' Financial Integrity Act of 1982 (FMFIA);
- Food, Agriculture, Conservation, and Trade Act of 1990;
- Food Security Act of 1985;
- Government Management Reform Act of 1994;
- Government Performance and Results Act of 1993;
- Real Estate Settlement Procedures Act of 1974, as amended; and
- Rural Electrification Act of 1936, as amended.

As part of the audit, we reviewed management's process for evaluating and reporting on internal control and accounting systems, as required by the FMFIA, and compared the most recent FMFIA reports with the evaluation we conducted of

Rural Development's internal control structure. We also reviewed and tested Rural Development's policies, procedures, and systems for documenting and supporting financial, statistical, and other information presented in the Overview and Required Supplemental Information sections. However, providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit, and accordingly, we do not express such an opinion.

Under FFMIA, we are required to report whether Rural Development's financial management systems substantially comply with Federal financial management systems requirements, Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance using the implementation guidance issued for FFMIA included in Appendix D of OMB Bulletin 98-08. The results of our tests disclosed instances where Rural Development's financial management systems did not substantially comply with the requirements.

Material instances of noncompliance are failures to follow requirements, or violations of prohibitions, contained in law or regulations that cause us to conclude that the aggregation of the misstatements resulting from those failures or violations is material to the financial statements, or the sensitivity of the matter would cause it to be perceived as significant by others. Material instances of noncompliance noted during our audit are presented in the "Findings and Recommendations" section of this report. Except for the items included therein, the results of our tests of compliance disclosed no other instances of noncompliance that are required to be reported under Government Auditing Standards or OMB Bulletin 98-08.

# FINDINGS AND RECOMMENDATIONS

## I. FINANCIAL MANAGEMENT SYSTEMS NEED SUBSTANTIAL IMPROVEMENT

### FINDING NO. 1

**R**ural Development's financial management systems did not substantially comply with the Federal Financial Management Improvement Act.<sup>2</sup> As a result, its systems hinder Rural Development's ability to provide credible and reliable financial data to manage its \$80 billion loan portfolio.

Rural Development is not currently in compliance with Section 4 of the FFMIA and OMB Circular A-127, "Financial Management Systems". Circular A-127 requires each agency to establish and maintain a single, integrated financial management system that complies with the applicable accounting principles, standards and related requirements defined by OMB and the Department of Treasury. The systems do not currently comply with Federal Financial Management Systems Requirements. Inadequacies include: inaccurate, inconsistent, and redundant data that cannot be readily accessed and used by financial and program managers without extensive manipulation; excessive manual processes; and inefficient balancing of reports to reconcile obligations, disbursements, collections and general ledger data.

The problems include:

- Rural Development's community, utilities, and business direct loan accounting systems and management information systems do not comply with Federal Financial Management System Requirements, or OMB Circular A-127. Additionally, the

---

<sup>2</sup>Under FFMIA, we are required to report whether Rural Development's financial management systems substantially comply with Federal financial management systems requirements, applicable accounting standards, and the U.S. Government Standard General Ledger at the transaction level.

current systems use non-integrated computing environments which do not meet management needs for program information. Rural Development has initiated a project to redesign, modernize, and integrate these systems to eliminate problems of inconsistent and redundant data as well as provide for single-source entry and data availability.

- Rural Development's legacy guaranteed loan system did not always provide sufficient, timely, accurate management information, and did not allow adequate monitoring of lender performance. Rural Development is in the process of implementing a new Guaranteed Loan System to address these weaknesses.
- The Dedicated Loan Origination and Servicing System, a new system for rural housing loans, continues to undergo improvement to ensure that it provides for proper accountability, reporting, and collection of interest credit recapture.
- Rural Development has not fully implemented OMB Circular A-129, "Policies for Federal Credit Programs and Non-Tax Receivables," for direct loans. Information is not always available to ensure collection of all receivables, evaluate credit policies, provide efficient and effective account servicing, and provide accurate, timely information.
- For FY 1998, Rural Development reported material weaknesses with the following:
  - Sufficient progress had not been made in the development and strengthening of controls for establishing and reestimating loan subsidy costs, which totaled over \$15.4 billion in FY 1998.
  - Effective management oversight in automated data processing modernization was lacking. Although progress had been made on addressing prior findings, Rural Housing Service had not completed corrective action related to information system security.
  - The Multi-Family Housing Program, with outstanding loans of over \$11.9 billion, lacks adequate oversight and internal controls. This has led to abuses in this program in the past.
- Rural Development is not in compliance with OMB Circular A-130, "Management of Federal Information Resources," regarding security over financial information.



Because Rural Development's financial information system cannot provide accurate and timely accounting and financial reporting, it is impossible to know how well or poorly the mission area has performed. When the underlying information providing the basis for decisions is called into question or when fundamental information is lacking, Rural Development's ability to make informed, "fact based" decisions is substantially hindered.

Rural Development acknowledges that it does not currently comply with FFMIA. Rural Development submitted its FFMIA Remediation Plan to the Office of the Chief Financial Officer on December 1, 1998. The plan shows remedial actions to be taken through FY 2001, including:

- Ensure that direct and guaranteed loan accounting systems provide necessary functionality and comply with Joint Financial Management Improvement Program (JFMIP) requirements.
- Provide automated processing of all transactions related to interest credit, including recapture and principal reduction attributed to subsidy.
- Implement OMB Circular A-129 for direct loans to ensure that accurate and timely information is available to, among other things, collect all receivables, evaluate credit policies, and provide efficient and effective account servicing.
- Ensure substantial compliance with OMB Circular A-127, "Financial Management Systems."
- Ensure substantial compliance with OMB Circular A-130, "Management of Federal Information Resources."
- Ensure that Rural Development's financial management systems are Year 2000 compliant.
- Prepare financial statements in accordance with applicable accounting standards.

As required by FFMIA, OIG will report on agency progress in achieving FFMIA compliance in our Semiannual Report to Congress. In order to do this, we will monitor Rural Development's progress in completing the detail actions shown in its Remediation Plan.

Because the Remediation Plan has only recently been developed, and corrective actions are planned to come into compliance with FFMIA, we are making no recommendations herein.

## II. DEBT COLLECTION NEEDS STRENGTHENING

### FINDING NO. 2

**R**ural Development is not in full compliance with the DCIA and/or OMB Circular A-129, "Policies for Federal Credit Programs and Non-Tax Receivables". Additional actions are necessary to collect delinquent debt and bar delinquent debtors from receiving additional Federal loans. Because of

the failure to implement these policies in FY 1998, Rural Development may have made loans to ineligible borrowers and may have missed opportunities to reduce its delinquent debt. As of fiscal yearend, Rural Development reported about \$378 million and \$53 million to Treasury for debt more than 30 days late for direct and guaranteed loans, respectively.

DCIA states that persons owing an outstanding Federal nontax debt in delinquent status are not eligible for additional Federal financial assistance (Federal loans, loan guarantees, loan insurance, etc.). In order to identify those ineligible applicants, Federal agencies must both report on and check for delinquent debt. OMB Circular A-129 requires the usage of various tools for preventing ineligible borrowers from receiving more Federal assistance. The required tools are: the Credit Alert Interactive Voice Response System (CAIVRS), credit reports, and credit applications.

We noted that Rural Development controls need strengthening to ensure that: (1) Borrowers with delinquent Federal debt are barred from receiving additional Federal assistance, and (2) the usage of collection tools is maximized. Details follow.

- Rural Development ceased reporting delinquent Single Family Housing borrowers to credit bureaus due to conversion from decentralized to centralized servicing in FY 1997. Rural Development has been researching questions regarding due process to inform its borrowers of the potential for credit bureau reporting. During FY 1999, Rural Development plans to provide notification to borrowers and begin reporting delinquent debt to credit bureaus.
- Rural Development and its guaranteed loan lenders did not report delinquent borrowers to CAIVRS. During FY 1998, only direct multi-family debt was reported to CAIVRS. Additionally, Rural Development did not access CAIVRS prior to

making direct loans. During FY 1998, only guaranteed loan lenders were provided the capability to access CAIVRS. Rural Development plans to begin accessing CAIVRS for Single Family Housing direct loans in FY 1999.

- ! Rural Development needs to take additional actions in order to fully comply with DCIA with respects to administrative offset and cross-servicing. Specifically, Rural Development is not submitting delinquent repurchased guaranteed loans and defaulted guaranteed loans to the Treasury Offset Program for collection.

## **RECOMMENDATION NO. 2**

Take appropriate actions to report repurchased guaranteed loans and defaulted guaranteed loans to the Treasury Offset Program. Develop a methodology to ensure that all programs maximize the usage of tools for barring ineligible borrowers from receiving Federal loans.

We considered these material instances of noncompliance in forming our opinion on whether the FY 1998 consolidated financial statements of the Rural Development are presented fairly, in all material respects, and this report does not modify the opinion on Rural Development's consolidated financial statements expressed in our report, dated January 5, 1999.

This report is intended for the information of the management of Rural Development, OMB and Congress. However, this report is a matter of public record and its distribution is not limited.

ROGER C. VIADERO  
Inspector General

January 5, 1999

---

## **EXHIBIT A: ABBREVIATIONS**

Act	-	Federal Credit Reform Act
CAIVRS	-	Credit Alert Interactive Voice Response System
CFO	-	Chief Financial Officer
CIO	-	Chief Information Officer
CPA	-	Certified Public Accounting
CSC	-	Centralized Servicing Center
DCIA	-	Debt Collection Improvement Act
DLOS	-	Dedicated Loan Origination and Servicing
FFMIA	-	Federal Financial Management Improvement Act
FMFIA	-	Federal Managers' Financial Integrity Act
FY	-	Fiscal Year
JFMIP	-	Joint Financial Management Improvement Program
OIG	-	Office of Inspector General
OMB	-	Office of Management and Budget
RHS	-	Rural Housing Service
USDA	-	U.S. Department of Agriculture

## **OVERVIEW OF RURAL DEVELOPMENT CONSOLIDATED STATEMENTS**

---

### *BACKGROUND*

This overview, in conjunction with the accompanying consolidated financial statements, footnotes, and supplemental information, reflects the activities of the Rural Development mission area of the United States Department of Agriculture (USDA). This mission area was created by legislation signed into law on October 13, 1994. Three agencies, the Rural Housing Service (RHS), Rural Utilities Service (RUS), and Rural Business-Cooperative Service (RBS) constitute the Rural Development mission area.

Rural Development's vision is to be a partner in helping the people of rural America develop sustainable communities. Its mission is to enhance the ability of rural communities to develop, to grow, and to improve their quality of life by targeting financial and technical resources in areas of greatest need through activities of greatest potential. Rural Development programs are designed to meet the diverse needs of rural communities and to help them obtain the financial and technical assistance needed to improve the quality of life in rural America and help individuals and businesses compete in the global marketplace. These programs consist of a variety of loan, loan guarantee, and grant programs, plus technical assistance, in the areas of business development; cooperative development; rural housing; community facilities; water and waste disposal; electric power; and telecommunications, including distance learning and telemedicine.

The Rural Development Strategic Plan dated September 1997 defines the mission area's goals. The Plan was prepared in accordance with the requirements of the Government Performance and Results Act of 1993, and describes Rural Development's anticipated accomplishments. The timeframe of this Plan is fiscal years 1997 through 2002. It includes Rural Development's goals and objectives as well as performance measures and indicators that provide a basis for measuring its success. Several of these performance measures have been included in the overview information accompanying these financial statements. Comparative numbers for 1996 have been included for informational purposes only.

Rural Development loan programs, with an outstanding portfolio of approximately \$79 billion, are delivered through a National Office for each agency and approximately 46 state, 246 district, 713 county offices and a Centralized Servicing Center located in St. Louis, Missouri which services the direct single family housing portfolio. The mission area serves approximately 618,253 single family housing borrowers, 16,010 multi-family housing borrowers, 11,715 community and business borrowers, and 1,676 telecommunications and electric borrowers.

### Loan Portfolio

Rural Development loan programs generally require (1) providing loans to individuals and enterprises who are at a greater risk of default, since they lack the financial resources to obtain credit in the private sector, and (2) making loans bearing an interest rate at or less than the cost of funds. While faced with these requirements, the responsibility exists to protect the interest of the Government and the private lending institutions when loans are guaranteed by adequately securing

## OVERVIEW OF RURAL DEVELOPMENT CONSOLIDATED STATEMENTS

the loans with real estate mortgages, assignments of income, personal and corporate guarantees, and liens on system revenues.

<b>Total Loan Portfolio as September 30, 1998</b>			
<b>Fiscal Years 1996 Through 1998</b>			
<b>(Dollars in Billions)</b>			
	FY 96	FY 97	FY 98
<b>Direct Loans</b>			
<b>RHS</b>			
Single Family Housing	\$18.0	\$17.5	\$17.1
Multi-Family Housing	11.8	11.9	11.9
Community Facilities/Other	1.1	1.2	0.6
<b>RUS</b>			
Water and Waste/Other	5.3	5.9	6.6
Electric	30.3	28.8	28.4
Telephone	3.7	3.7	3.7
Rural Telephone Bank	1.5	1.4	1.4
<b>RBS</b>			
Business and Industry	0.3	0.3	0.4
<i>Total Direct</i>	72.0	70.7	70.1
<b>Guaranteed Loans</b>			
<b>RHS</b>			
Single Family Housing	3.2	4.6	6.5
Multi-Family Housing	0.01	0.04	0.02
Community Facilities/Other	0.1	0.1	0.1
<b>RUS</b>			
Water and Waste/Other	0.3	0.7	0.2
Electric	0.7	0.6	0.6
<b>RBS</b>			
Business and Industry	0.6	1.0	1.5
<i>Total Guaranteed</i>	4.9	6.5	8.9
<i>Total Loan Portfolio</i>	\$76.9	\$77.2	\$79

The obligations for the loan portfolio were slightly higher in FY 1998 than in FY 1997. Increases in the obligations in FY 1998 were due to changing interest rates which impacted the program subsidy rate, therefore increasing the available program level funding.

**OVERVIEW OF RURAL DEVELOPMENT CONSOLIDATED STATEMENTS**

Performance Measure: Comparison of Loan Obligations (Major Program Areas) (Dollars in Millions)						
	FY 96		FY 97		FY 98	
	Total Amount	Total Loans	Total Amount	Total Loans	Total Amount	Total Loans
<i>Direct Loans</i>						
<b>RHS</b>						
Single Family	\$1,052	26,121	\$737	19,708	\$1,038	22,730
Multi-Family	167	350	72	267	71	264
Community Facilities	208	315	137	343	211	424
<b>RUS</b>						
Water/Waste	605	898	833	1,003	787	949
Electric	823	131	824	136	925	171
Telecommunications	493	106	381	79	565	110
<b>RBS</b>						
Rural Economic Development Loans	0	0	12	39	25	62
Business & Industry	0	0	12	33	21	74
Intermediary Relending Program	38	47	37	53	35	47
<i>Guaranteed Loans</i>						
<b>RHS</b>						
Single Family	1,700	25,153	2,000	29,354	2,822	39,403
Multi-Family	13	10	28	18	39	29
Community Facilities	56	65	82	80	65	69
<b>RUS</b>						
Water/Waste	59	13	2.8	9	15	14
<b>RBS</b>						
Business and Industry	638	562	828	692	1,171	801

The trend in Rural Development has been away from providing direct loans to guaranteed loans. For example, both the SFH and the Business and Industry guaranteed loan program obligations increased by 41 percent during FY 1998. The MFH guaranteed loan program which was not funded until FY 1996 increased by 39 percent to 39 million.

***Rural Housing Service***

The RHS mission is to improve the quality of life in rural America and help build competitive, vibrant rural communities through its community facilities and housing programs.

## OVERVIEW OF RURAL DEVELOPMENT CONSOLIDATED STATEMENTS

### Single Family Housing Programs

RHS provides financing, with no down payment and at favorable rates and terms, either through a direct loan with RHS or with a loan from a private financial institution which is guaranteed by RHS. The direct SFH program is the largest component of the rural housing portfolio. Direct SFH loans are made to families or individuals with very low, low, and moderate income to buy, build, improve, repair, and/or rehabilitate rural homes. These loans are normally repayable over 33 years at an effective interest rate as low as 1 percent annually. The average interest rate for Fiscal Year (FY) 1998 was 6.11 percent with 46 percent of all SFH borrowers receiving interest assistance. RHS provides grants to enable very low income rural homeowners to remove health and safety hazards in their homes and to make homes accessible for people with disabilities.

During FY 1997, RHS made a significant change in the way it conducted its business. Although field offices still handled the loan application process, the Centralized Servicing Center handled all phases of loan servicing, from risk management to borrower assistance. In addition, RHS offers escrow accounts for property taxes and insurance for its home loan borrowers.

The table which follows shows some of the performance measures for single family housing programs.

Performance Measures	FY 1996	FY 1997	FY 1998
Provide 75,000 rural households with improved or more suitable housing through home ownership	44,413	43,463	57,106
Maintain currency rate of 90 percent for single family housing borrowers	93	(a)	81

(a) Delinquency information was not calculated due to the loan portfolio being serviced by separate systems during the year.

Guaranteed loans make up the remaining portion of the SFH portfolio, which guarantees 90 percent of the loan amount. These loans are normally repaid over 30 years with the interest rates negotiated between the borrower and the lender. The guaranteed rural housing program continues to demonstrate its commitment to achieve maximum leveraging. As shown on the chart below, the program has grown significantly since 1991, with a 39 percent increase in the number of borrowers guaranteed between FY's 1997 and 1998.

	FY 1996	FY 1997	FY 1998
Total Number of Loans	56,579	79,118	110,015
Total Number of Borrowers	56,554	79,087	109,979
Total Portfolio	\$3.2 billion	\$4.6 billion	\$7.2 billion



**OVERVIEW OF RURAL DEVELOPMENT CONSOLIDATED STATEMENTS**

**Community Facility Programs** The guaranteed program for Community Facilities declined by 21 percent this year to a total of \$65 million.

Rural Development strives to improve the quality of life of rural residents by providing access to modern, essential community facilities such as fire stations, health care clinics and child care facilities. RHS continues to offer both direct and guaranteed loans which are made available to public entities such as municipalities, counties, and special purpose districts as well as nonprofit corporations and tribal governments. These loans are repayable up to 40 years. During FY 97, RHS introduced a grant program for essential community facilities that will help reach lower income communities.

Performance Measures	FY 1996	FY 1997	FY 1998
Provide 500 communities with new or improved essential community facilities	380	567	745
Maintain currency rate of 98 percent	98	99	99
Invest 3.5 percent of community facility direct funds in EZ/EC Communities	3.5	4.5	2.0

**Multi-Family Housing Programs**

The Multi-Family Housing program finances farm labor housing, rural rental housing, and cooperative housing for low income and elderly people in rural communities of under 10,000 population. Farm labor housing loans and grants enable farmers, public or private nonprofit organizations, and units of state and local governments to develop or rehabilitate farm labor housing for seasonal and year round workers. These loans are generally repayable over 33 years at an interest rate of as low as 1 percent annually. Rural rental housing loans enable developers to provide housing for the elderly, disabled individuals, and families who cannot afford the purchase price and maintenance costs of their own houses. These loans are generally repayable over 50 years at an average interest rate of 3.01 percent. RHS provides grants to enable farmers, public or private organizations, and units of State and local governments to build, buy, or repair farm labor housing. In addition, grants are provided to public nonprofit organizations to assist rental property owners and co-ops to repair and rehabilitate their units.

During FY 1996, RHS initiated a demonstration guaranteed loan program for MFH projects. Because of its success, RHS was successful in obtaining lender participation and the program was permanently authorized.

To measure its success, the Multi-Family Housing programs have established the following performance measures.

Performance Measures	FY 1996	FY 1997	FY 1998
Provide 100 communities with improved rental housing	316	244	266
97% currency rate for multi-family housing borrowers	98%	98%	98%

## OVERVIEW OF RURAL DEVELOPMENT CONSOLIDATED STATEMENTS

### *Rural Utilities Service*

The RUS seeks to improve the quality of life in rural America through a variety of loan, loan guarantee, and grant programs for electric energy, telecommunications (including distance learning and telemedicine), and water and waste projects. The RUS programs leverage scarce federal funds with private capital for investing in rural infrastructure, technology, and the development of human resources. Financial assistance is provided to rural utilities, municipalities, commercial corporations, public utility districts, Indian Tribes, and cooperative, nonprofit, limited-dividend, or mutual associations. These entities are obligated to serve the public welfare and, in many instances, are subject to state regulatory oversight.

### **Electric Program**

As part of the restructuring of the electric utility industry, Rural Development is ensuring the continued availability of reliable, high-quality electric service at reasonable cost to rural consumers. Electric borrowers have received over \$56.6 billion in direct loans and guaranteed loans as of September 30, 1998. During FY 1998, loans and guarantees totaling \$925 million were approved. For Federal budgeting and accounting purposes, loans made by the Federal Financing Bank (FFB) under a RUS guarantee are considered direct loans. In addition to loans and guarantees approved, another \$133.1 million in loans were repriced and loans totaling \$1,487 million were refinanced during the year.

Performance Measures	FY 1996	FY 1997	FY 1998
Leverage \$2.75 of private funds in rural electric infrastructure for every \$1 of RUS electric program loan advances.	2.2	3.44	2.6
Provide financial assistance for 45 electric systems in the 540 persistent poverty counties	53 loans \$420 million	58 loans \$304 million	74 loans \$539 million
Provide financial assistance for 80 electric systems in the 700 counties with persistently declining populations.	87 loans \$511 million	87 loans \$329 million	72 loans \$286 million
Provide 1.6 million residents with improved electrical systems.	3.0 million	2.0 million	2.8 million

Until 1973, almost all Federal financing to electric borrowers was supplied by direct loans at an interest rate of two percent. Since 1973, the agency has made both direct and guaranteed loans.

Since 1973, direct loans have been generally reserved for electric distribution facilities, and most borrowers must obtain 30 percent of their debt financing from a private lender without a federal guarantee. From 1973 until the end of 1993, direct loans had a fixed interest rate of five percent. Since December 1993, there have been two types of direct loans: municipal rate loans and hardship rate loans.

Municipal rate loans have a variable interest rate structure, with rates tied to interest rates on municipal bonds. If the borrower meets certain tests with respect to cost of service and the income of its consumers, the interest rate is

**OVERVIEW OF RURAL DEVELOPMENT CONSOLIDATED STATEMENTS**

capped at 7 percent. Borrowers who meet more stringent tests with respect to high cost of service and low consumer density are eligible for hardship rate loans that have interest rates fixed at five percent.

Loan guarantees may be made for generation, transmission, or distribution facilities. The lender for most loan guarantees is the Federal Financing Bank (FFB), part of the US Department of the Treasury. Interest rates are tied to Treasury’s cost of borrowing.

**Telecommunications Program**

The telecommunications program provides capital, establishes telecommunications standards, and provides policy guidance for rural telecommunications. In the RUS Telecommunications Infrastructure Loan programs, the agency approved \$565 million in loans in FY 1998 to 53 borrowers, utilizing all of its Hardship loan funds and over 96 percent of its authorized funding for Cost of Money and Rural Telephone Bank (RTB) loans. RUS has provided over \$12.6 billion in financing to telecommunications borrowers and principal outstanding totals more than \$5 billion.

Performance Measures	FY 1996	FY 1997	FY 1998
Leverage \$6 in private funds in rural telecommunications infrastructure for every \$1 of RUS telecommunications program loan advances	5.7	4.9	4.7
Provide 1.8 million residents and businesses with improved telecommunication service	1.4 million	0.8 million	1.2 million
Provide 46 schools with transmission facilities for distance learning applications	36	29	16

The telecommunication program also administers RUS Distance Learning and Telemedicine (DLT) loan and grant program. In FY 1998, the DLT program made 60 awards to rural educational centers and health care providers totaling \$12.5 million in grants and \$3.5 million in loans. This is the highest approval level in a fiscal year since the program began in FY 1993. Since the inception of the DLT program in 1993, the program has funded 252 projects in 43 states and two territories totaling \$67.4 million; \$62.3 million in grants and \$5.1 million in loans.

The telecommunication program is providing many opportunities to rural communities across the US to receive funding for the purpose of putting advanced telecommunications technologies to work for rural residents. From enhanced educational opportunities over distance learning networks, to life saving procedures through telemedicine, to economic growth utilizing the global digital network, the telecommunications program is wiring rural America to the 21st century. In the deregulated and newly created competitive industry environment, established by the passage of the Telecommunications Act of 1996, the telecommunications program is continuing its efforts toward streamlining its operations and increasing customer service by evaluating key regulatory policies and implementing new initiatives to more efficiently administer its programs. Of particular interest is the agency’s efforts to revise

## OVERVIEW OF RURAL DEVELOPMENT CONSOLIDATED STATEMENTS

and streamline its mortgage and loan contracts. The focus will be to preserve loan security while providing borrowers with flexibility as they enter the newly competitive marketplace.

### **Water and Waste Program**

Water and waste disposal loans and grants are provided to rural communities for the development, replacement, or upgrading of water and waste disposal facilities. Direct water and waste loans are repayable up to 40 years. Water and Waste borrowers have received a total of \$22.7 billion in direct loans, loan guarantees, and grants as of September 30, 1998. During FY 1998, \$787 million in direct loans, \$15.4 million in loan guarantees, and \$469 million in grants were approved.

Performance Measures	FY 1996	FY 1997	FY 1998
Provide financial assistance for 216 water and waste systems in the 540 persistent-poverty counties	185 \$135 million	221 \$505 million	211 \$264 million
Provide financial assistance for 183 water and waste systems in the 700 counties with persistently declining populations	156 \$131 million	184 \$372 million	185 \$218 million
Provide 1.7 million people with safe, affordable drinking water	1.3 million	1.1 million	1.3 million
Provide central water and waste disposal service to 277,000 rural residents who previously did not have service	217,025	584,600	637,188
Provide 648,000 people with improved, safe, affordable waste disposal service	482,000	475,157	608,429

### ***Rural Business-Cooperative Service***

The mission of RBS is to enhance the quality of life for all rural Americans by providing leadership in building competitive businesses and sustainable cooperatives that can prosper in the global marketplace. RBS accomplishes this mission by investing its financial resources and technical assistance in businesses and cooperatives, and by building partnerships that leverage public, private, and cooperative resources to create jobs and stimulate rural economic activity. This is accomplished through the delivery of a variety of loan, loan guarantee, and grant programs.

Under the B&I Guaranteed and Direct Loan Programs, financial assistance is provided to virtually any legally organized entity, including cooperatives, corporations, partnerships, trusts, or other profit or nonprofit entities, Indian Tribes, or a Federally recognized Tribal group, municipalities, counties, or another political subdivision of a State. Applicants need not have been denied credit elsewhere to apply for this program.

The Intermediary Relending Program (IRP) and Rural Business Enterprise Grant (RBEG) Program provide financial assistance to eligible entities including public bodies, nonprofit corporations, Indian tribes, and cooperatives.

## OVERVIEW OF RURAL DEVELOPMENT CONSOLIDATED STATEMENTS

The Rural Economic Development (Zero-Interest) Loan (REDL) and Grant Programs provide financial assistance to Rural Utilities Service borrowers to assist in developing rural areas, from an economic standpoint, to create new job opportunities and help retain existing employment.

Delinquency rates for the B&I Guaranteed Loan Program have remained consistent at a 5 percent rate at year end FY 1998.

Performance Measures	FY 1996	FY 1997	FY 1998
Invest 20% of Rural Business Enterprise Grant funds in EZ/EC Communities	19.3% \$8.5 million	18.2% \$8.3 million	22.3% \$8.3 million
Invest 21% of Intermediary Relending Program funds in EZ/EC Communities	19.3% \$7.3 million	19.4% \$7.2 million	17% \$6 million
Invest 1.1% of B&I Guaranteed Loan Program Funds in EZ/EC Communities	.39% \$2.5 million	1.3% \$10.4 million	1.3% \$15 million
Maintain a 91% currency rate for guaranteed Business and Industry loans	91%	94%	95%
Maintain a 100% currency rate for Intermediary Relending Program loans	(a)	100%	97%

(a) This information is maintained on a stand-alone database and the currency rate was not calculated for previous years.

### Year 2000 (Y2K) Issues

Rural Development has identified 16 systems that are considered mission critical. Two of Rural Development's 16 mission-critical systems, Community, Utilities, and Business System and New Guaranteed Loan System, are currently being developed as Year 2000 compliant systems.

The 14 mission-critical systems being repaired have been renovated. Eleven of the systems have been fully renovated, validated, and implemented. The remaining three systems are being validated. The following table provides the four-phase process of repairing the 14 mission-critical systems with milestone dates and current status.

Repair Phases	Milestone Date	Number Completed
Assessment	6/97	14
Renovation	9/98	14
Validation	12/98	11
Implementation	3/99	11

Rural Development has 21 non-mission critical systems. Seven of these systems are Year 2000 compliant, five systems are being retired, and two systems are being replaced. Of the seven non-mission critical systems being repaired, five have been fully renovated, validated, and implemented. The remaining two systems are being renovated/validated. The following table provides the four-phase process of repairing the seven non-mission critical systems with milestone dates and current status.

## OVERVIEW OF RURAL DEVELOPMENT CONSOLIDATED STATEMENTS

For Those Systems Being Repaired	Number Completed	Expected Dates for Completion
Assessment	7	Completed
Renovation	6	1/99
Validation	5	2/99
Implementation	5	3/99

All Rural Development systems are scheduled to be Year 2000 compliant by March 1999.

In addition to all automated systems, Rural Development is ensuring that all information technology areas are Year 2000 compliant including telecommunications, firmware, operating systems, hardware, and software packages for the three Rural Development service areas (Rural Business-Cooperative Service, Rural Housing Service, and Rural Utilities Service) which has several office locations in St. Louis, several office locations in Washington, D.C., and field office locations throughout the country.

Rural Development has a total of 31 data exchanges with 5 Federal external entities and 17 data exchanges with 7 private external entities. Contacts have been made with all external entities and verbal agreements reached on the format of data exchanges. Formal agreements are being pursued with all of the external entities.

An estimated \$4.069 million will be spent by Rural Development from Fiscal Year 1996 through Fiscal Year 2000 to resolve the Year 2000 problem. The following table provides the estimated cost by fiscal year for Rural Development to resolve the Year 2000 problem.

Fiscal Year	1996	1997	1998	1999	2000	Total
Telecommunications Cost						
All Other Information Technology Costs	.125	.4	2.154	1.39		4.069

The Rural Development Business Continuity (Contingency) Plan (BCP) based on the Year 2000 Business Continuity (Contingency) Planning Guide included with the July 2, 1998, memorandum from the Chief Information Officer was submitted to the Office of the Chief Information Officer on October 30, 1998.

The BCP provides guidance and direction to all managers and staff in Rural Development including RBS, RHS, and RUS, and action to be taken in the event of disruptions to our normal business operations due to impact to the millennium date change.

The BCP prepares the Rural Development mission area to avoid a crisis that will result if systems are unable to recognize Year 2000 dates. Resources critical to operating Rural Development core business processes and key support processes are identified to provide a basic level of services until the

## OVERVIEW OF RURAL DEVELOPMENT CONSOLIDATED STATEMENTS

---

normal level of services can be restored to all customers. The BCP identifies risks and threats, establishes mitigation strategies for the identified risks and threats, and provides contingencies in the event risk mitigation efforts fail.

The BCP is a living document and Rural Development will continue to augment the plan as progress is made, testing is accomplished, and new issues emerge.

### *Financial Statements*

The accompanying financial statements include the combined financial information for rural housing, rural utilities and rural business and community development programs.

These consolidated financial statements have been prepared to report the financial position and results of operations, pursuant to the requirements of the Chief Financial Officers Act of 1990. While the statements have been prepared from the books and records of the entity in accordance with the formats prescribed by the Office of Management and Budget, the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records. The statements should be read with the realization that they are a component of the U.S. Government, a sovereign entity. One implication of this is that liabilities cannot be liquidated without legislation that provides resources to do so.

**U.S. DEPARTMENT OF AGRICULTURE  
RURAL DEVELOPMENT  
CONSOLIDATED BALANCE SHEET  
AS OF SEPTEMBER 30, 1998**  
(Dollars in Thousands)

**ASSETS**

*Assets for Use By Entity*

Federal:

Fund Balance with Treasury (Note 2)	\$ 6,479,356
Accounts Receivable (Note 4)	4,395
Receivable from Appropriations	3,954,709

Non-Federal:

Accounts Receivable, Net (Note 4)	764
Credit Program Receivables, Net Present Value (Note 5)	54,994,461
Advances and Prepayments	54
Other Assets (Note 7)	54,707
General Property, Plant, and Equipment, Net (Note 6)	<u>8,754</u>

*Total Assets For Use By Entity* \$ 65,497,200

*Assets Not For Use By Entity*

Federal:

Accounts Receivable (Note 4)	\$ 3
------------------------------	------

Non-Federal:

Cash and Other Monetary Assets (Note 3)	18,859
Accounts Receivable, Net (Note 4)	<u>46</u>

*Total Assets Not For Use By Entity* \$ 18,908

Total Assets \$ 65,516,108

---

**The accompanying notes are an integral part of these statements.**



**U.S. DEPARTMENT OF AGRICULTURE  
RURAL DEVELOPMENT  
CONSOLIDATED BALANCE SHEET  
AS OF SEPTEMBER 30, 1998**  
(Dollars in Thousands)

**LIABILITIES**

*Liabilities Covered by Budgetary Resources*

Federal:

Accounts Payable	\$ 349,496
Interest Payable (Note 9)	727,747
Debt (Note 9)	53,246,567
Resources Payable to Treasury	5,070,090

Non-Federal:

Accounts Payable	65,669
Interest Payable	10,005
Stock Payable to RTB Borrowers (Note 8)	743,029
Debt (Note 9)	819,789
Estimated Losses (Present Value) on Loan Guarantees (Note 5)	460,650
Accrued Program Liabilities (Note 10)	19,052
Unearned Revenue	(8,373)
Trust and Deposit Liabilities	19,979
Other Liabilities (Note 11)	28,519

*Total Liabilities Covered by Budgetary Resources* \$ 61,552,219

*Liabilities Not Covered by Budgetary Resources*

Non-Federal:

Annual Leave	\$ 32,114
Federal Employees Compensation Act	15,704

*Total Liabilities Not Covered by Budgetary Resources* \$ 47,818

Total Liabilities \$ 61,600,037

---

**The accompanying notes are an integral part of these statements**

**U.S. DEPARTMENT OF AGRICULTURE  
RURAL DEVELOPMENT  
CONSOLIDATED BALANCE SHEET  
AS OF SEPTEMBER 30, 1998**  
(Dollars in Thousands )

**NET POSITION**

Unexpended Appropriations (Note 12)	\$ 4,324,825
Cumulative Results of Operations (Note 12)	<u>(408,754)</u>
Total Net Position	<u>\$ 3,916,071</u>
Total Liabilities and Net Position	<u><u>\$ 65,516,108</u></u>

---

The accompanying notes are an integral part of these statements.

**U.S. DEPARTMENT OF AGRICULTURE  
RURAL DEVELOPMENT  
CONSOLIDATING STATEMENT OF NET COST  
FOR THE YEAR ENDED SEPTEMBER 30, 1998**  
(Dollars in Thousands)

	<b>MORTGAGE CREDIT</b>	<b>HOUSING ASSISTANC E</b>	<b>COMMUNITY DEVELOPMENT</b>	<b>AREA &amp; REGIONAL DEVELOPMENT</b>
<b>Costs:</b> (Note: 14)				
<b>Program Costs:</b>				
Federal	\$ 2,338,049	\$ 0	\$ 10,687	\$ 973,740
Non-Federal:				
Grants and Transfers	446,524	563,846	598,541	57,320
Other Program Costs	616,861	0	(25)	201,221
Total Program Production Costs	<u>\$ 3,401,434</u>	<u>\$ 563,846</u>	<u>\$ 609,203</u>	<u>\$ 1,232,281</u>
Less Earned Revenues (Note 15)	(2,202,643)	0	0	(971,173)
Excess Production Costs Over Revenues	<u>\$ 1,198,791</u>	<u>\$ 563,846</u>	<u>\$ 609,203</u>	<u>\$ 261,108</u>
Net Program Costs	<u>\$ 1,198,791</u>	<u>\$ 563,846</u>	<u>\$ 609,203</u>	<u>\$ 261,108</u>
Costs Not Assigned to Programs				
<b>NET COST OF OPERATIONS</b>	<u><u>\$ 1,198,791</u></u>	<u><u>\$ 563,846</u></u>	<u><u>\$ 609,203</u></u>	<u><u>\$ 261,108</u></u>

The accompanying notes are an integral part of these statements.

**U.S. DEPARTMENT OF AGRICULTURE  
RURAL DEVELOPMENT  
CONSOLIDATING STATEMENT OF NET COST  
FOR THE YEAR ENDED SEPTEMBER 30, 1998**  
(Dollars in Thousands)

	<u>ENERGY SUPPLY &amp; CONSERVATION</u>	<u>OTHER</u>	<u>INTRA-AGENCY ELIMINATIONS</u>	<u>TOTAL</u>
<b>Costs:</b> (Note: 14)				
<b>Program Costs:</b>				
Federal	\$ 2,133,824	\$ 0	\$ (440,845)	\$ 5,015,455
Non-Federal:				
Grants and Transfers	(47,404)	194	0	1,619,021
Other Program Costs	<u>(1,375,699)</u>	<u>0</u>	<u>0</u>	<u>(557,642)</u>
Total Program Production Costs	\$ 710,721	\$ 194	\$ (440,845)	\$ 6,076,834
Less Earned Revenues (Note 15)	<u>(2,358,574)</u>	<u>(143)</u>	<u>440,845</u>	<u>(5,091,688)</u>
Excess Production Costs Over Revenues	\$ (1,647,853)	\$ 51	\$ 0	\$ 985,146
Net Program Costs	<u>\$ (1,647,853)</u>	<u>\$ 51</u>	<u>\$ 0</u>	<u>\$ 985,146</u>
Costs Not Assigned to Programs				<u>13,956</u>
<b>NET COST OF OPERATIONS</b>	<u><u>\$ (1,647,853)</u></u>	<u><u>\$ 51</u></u>	<u><u>\$ 0</u></u>	<u><u>\$ 999,102</u></u>

---

The accompanying notes are an integral part of these statements.

**U.S. DEPARTMENT OF AGRICULTURE  
RURAL DEVELOPMENT  
CONSOLIDATING STATEMENT OF CHANGES IN NET POSITION  
FOR THE YEAR ENDED SEPTEMBER 30, 1998**  
(Dollars in Thousands)

	<u>MORTGAGE CREDIT</u>	<u>HOUSING ASSISTANCE</u>	<u>COMMUNITY DEVELOPMENT</u>	<u>AREA &amp; REGIONAL DEVELOPMENT</u>
<b>Net Cost of Operations</b>	\$ (1,198,791)	\$ (563,846)	\$ (609,203)	\$ (261,108)
<b>Financing Sources</b> (other than exchange revenues):				
Appropriations Used	679,448	563,846	562,852	69,121
Recovery of Appropriations Used	3,751	0	0	14,319
Imputed Financing	50,047	0	0	3,733
Other Financing Sources	0	0	0	9,831
Transfers-in	0	0	0	6,046
Transfers-out	<u>(24,930)</u>	<u>0</u>	<u>(33,983)</u>	<u>(22,265)</u>
Net Results of Operations	\$ (490,475)	\$ 0	\$ (80,334)	\$ (180,323)
Net Results Not Affecting Net Position	239,871	0	(10,119)	162,919
Prior Period Adjustments	<u>0</u>	<u>0</u>	<u>0</u>	<u>9,647</u>
Net Change in Cumulative Results of Operations	(250,604)	0	(90,453)	(7,757)
Increase (Decrease) in Unexpended Appropriations	<u>(203,456)</u>	<u>3,232</u>	<u>13,994</u>	<u>(66,892)</u>
Change in Net Position	\$ (454,060)	\$ 3,232	\$ (76,459)	\$ (74,649)
Net Position-Beginning of Period as Previously Reported	<u>\$ 627,980</u>	<u>\$ 1,743,152</u>	<u>\$ 1,723,893</u>	<u>\$ 333,469</u>
<b>Net Position-End of Period</b>	<u><u>\$ 173,920</u></u>	<u><u>\$ 1,746,384</u></u>	<u><u>\$ 1,647,434</u></u>	<u><u>\$ 258,820</u></u>

**The accompanying notes are an integral part of these statements.**

**U.S. DEPARTMENT OF AGRICULTURE  
RURAL DEVELOPMENT  
CONSOLIDATING STATEMENT OF CHANGES IN NET POSITION  
FOR THE YEAR ENDED SEPTEMBER 30, 1998**

(Dollars in Thousands)

	<b>ENERGY SUPPLY &amp; CONSERVATION</b>	<b>OTHER</b>	<b>COSTS NOT ASSIGNED TO PROGRAMS</b>	<b>TOTAL</b>
	<u>                    </u>	<u>                    </u>	<u>                    </u>	<u>                    </u>
<b>Net Cost of Operations</b>	\$ 1,647,853	\$ (51)	\$ (13,956)	\$ (999,102)
<b>Financing Sources</b> (other than exchange revenues):				
Appropriations Used	123,864	194	0	1,999,325
Recovery of Appropriations Used	0	0	0	18,070
Imputed Financing	6,146	0	13,956	73,882
Other Financing Sources	0	0		9,831
Transfers-in	0	0		6,046
Transfers-out	(187,621)	0		(268,799)
Net Results of Operations	<u>\$ 1,590,242</u>	<u>\$ 143</u>	<u>\$ 0</u>	<u>\$ 839,253</u>
Net Results Not Affecting Net Position	(1,675,221)	5,903		(1,276,647)
Prior Period Adjustments	<u>0</u>	<u>0</u>		<u>9,647</u>
Net Change in Cumulative Results of Operations	(84,979)	6,046	0	(427,747)
Increase (Decrease) in Unexpended Appropriations	<u>(144,687)</u>	<u>941</u>		<u>(396,868)</u>
Change in Net Position	<u>\$ (229,666)</u>	<u>\$ 6,987</u>	<u>\$ 0</u>	<u>\$ (824,615)</u>
Net Position-Beginning of Period as Previously Reported	<u>\$ 311,873</u>	<u>\$ 319</u>	<u>\$ 0</u>	<u>\$ 4,740,686</u>
<b>Net Position-End of Period</b>	<u><u>\$ 82,207</u></u>	<u><u>\$ 7,306</u></u>	<u><u>\$ 0</u></u>	<u><u>\$ 3,916,071</u></u>

The accompanying notes are an integral part of these statements.

**U.S. DEPARTMENT OF AGRICULTURE  
RURAL DEVELOPMENT  
CONSOLIDATED STATEMENT OF  
BUDGETARY RESOURCES  
FOR THE YEAR ENDED SEPTEMBER 30, 1998**  
(Dollars in Thousands)

**Budgetary Resources**

Budget authority	\$ 10,471,352
Unobligated balances - beginning of period	1,428,273
Spending authority from offsetting collections	6,776,457
Adjustments	(6,953,986)
Total budgetary resources	<u><u>\$ 11,722,096</u></u>

**Status of Budgetary Resources**

Obligations incurred	\$ 10,505,528
Unobligated balances-available	89,068
Unobligated balances-not available	1,127,500
Total status of budgetary resources	<u><u>\$ 11,722,096</u></u>

**Outlays**

Obligations incurred	\$ 10,505,528
Less: Spending authority from offsetting collections and adjustments	(7,655,756)
Obligated balance, net - beginning of period	13,403,937
Less: Obligated balance, net - end of period	(12,733,101)
Total outlays	<u><u>\$ 3,520,608</u></u>

---

The accompanying notes are an integral part of these statements.

**U.S. DEPARTMENT OF AGRICULTURE  
RURAL DEVELOPMENT  
CONSOLIDATED STATEMENT OF FINANCING  
FOR THE YEAR ENDED SEPTEMBER 30, 1998**

*(Dollars in Thousands)*

**Resources Used to Finance Operations**

Budgetary	
Budgetary Resources Obligated for Items to Be Received or Provided to Others	\$ 10,505,528
Less: Offsetting Collections, Recoveries of Prior-year Authority, and Changes in Unfilled Customer Orders	(7,655,756)
Net Budgetary Resources Used to Finance Operations	<u>2,849,772</u>
Non-budgetary	
Costs Incurred by Others Without Reimbursements	<u>73,882</u>
Net Non-budgetary Resources Used to Finance Operations	<u>73,882</u>
Total Resources Used to Finance Operations	\$ 2,923,654

**Resources Used to Fund Items Not Part of the Net Cost of Operations**

Increase or (Decrease) in Budgetary Resources Obligated to Order Goods or Services Not Yet Received or Benefits Not Yet Provided	\$ 2,823
Budgetary Offsetting Collections Not Increasing Earned Revenue or Decreasing Expense	4,348,156
Adjustments Made to Compute Net Budgetary Resources Not Affecting Net Cost of Operations	(1,163,531)
Resources Financing the Acquisition of Assets or Liquidation of Liabilities	(3,127,392)
Other Resources Used to Fund Items Not Part of the Net Cost of Operations	<u>(9,647)</u>
<b>Total Resources Used to Fund Items Not Part of the Net Cost of Operations</b>	<b>\$ 50,409</b>

**Resources Used to Finance the Net Cost of Operations**

\$ 2,974,063

**Components of Net Cost of Operations Not Requiring or Generating Resources During the Reporting Period**

Expenses or Earned Revenue Related to the Disposition of Assets or Liabilities, or Allocation of Their Cost over Time	\$ (2,360,054)
Expenses Which Will Be Financed with Budgetary Resources Recognized in Future Periods	385,093
<b>Total Components of Net Cost of Operations Not Requiring or Generating Resources During the Reporting Period</b>	<b><u>(1,974,961)</u></b>

**NET COST OF OPERATIONS**

**\$ 999,102**

---

The accompanying notes are an integral part of these statements.



**RURAL DEVELOPMENT  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
AS OF SEPTEMBER 30, 1998**

**NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**A. Basis of Presentation**

These financial statements have been prepared to report the financial position and results of operations of the USDA Rural Development mission area, as required by the Chief Financial Officers Act of 1990. The financial statements have been prepared from the books and records in accordance with the Office of Management and Budget (OMB) Bulletin 97-01, *Form and Content of Agency Financial Statements*, and the accounting policies which are summarized in this note. These statements are, therefore, different from the financial reports, also prepared pursuant to OMB directives, that are used to monitor and control the use of budgetary resources.

**B. Reporting Entity**

As of September 30, 1998, the mission area provides credit for housing, rural development, and rural utilities within the U.S. Department of Agriculture (USDA). When it began in 1935, under the name of the Resettlement Administration, the Agency's original function was to make loans and grants to depression-stricken families and help them regain self-sufficiency in making their living on family farms. In 1937, the Farm Security Administration (FSA) was created as successor to the Resettlement Administration. Its primary responsibilities were to make farm rehabilitation and farm ownership loans to farmers unable to borrow from usual sources of credit.

In 1946, Congress passed the Farmers Home Administration Act and the name "FHA" was adopted. The Act gave FHA the authority to administer farm ownership loans, farm operating loans, a limited water facilities loan program, and the emergency crop and feed loan program. FHA was also authorized to insure and guarantee loans made by banks, other agencies, private citizens, as well as to make direct Government loans.

During the 1960's, pursuant to the Housing Act of 1949, FHA was given the authority to administer direct and insured loans to repair or purchase new or existing housing to very low-income and low income rural residents who could not obtain credit elsewhere. These loans provided rural residents with modest, safe, and sanitary single family dwellings at affordable rates and terms. In addition, FHA was granted authority to administer rental and cooperative housing loans, farm labor housing loans, and rural housing site loans to rural areas.

The agency was commonly known as "FHA" until April 1974 when USDA formally adopted "FmHA" as the agency's abbreviation. This was done to easily distinguish Farmers Home Administration from other agencies having the same initials, such as the Federal Housing Administration and Federal Highway Administration.

The Rural Electrification Administration (REA) was established under the Rural Electrification Act of 1936 as a credit agency within the USDA which assisted rural electric and telephone utilities in obtaining the financing required to provide electric and telephone service in rural areas.

In 1971, the Rural Telephone Bank (RTB) was established within REA to provide a supplemental source of financing for rural telephone systems. In 1987, the program was further expanded to provide zero-interest loans and grants to its borrowers for the purpose of rural development.

In 1992, the Rural Development Agency (RDA) was established by the Food, Agriculture, Conservation and Trade (FACT) Act. RDA was a separate agency within the Department of Agriculture which provided funding for loans, grants, and loan guarantees for community development in rural areas. The Health and Human Services Act of 1986 authorized further rural development lending by instituting the Intermediary Relending Program. Under this program, RDA provided loans to public or private nonprofit organizations for the purpose of relending for business or community development in rural areas.

On October 13, 1994, the President signed the Federal Crop Insurance Reform and Department of Agriculture Reorganization Act of 1994, Public Law No. 103-354. The law permits the reorganization of the Department, including the establishment of subcabinet positions, the restructuring of headquarters agencies and offices, continued reductions in the numbers of USDA personnel, and consolidation and closure of field office locations. This streamlining of the Department will permit USDA to deliver programs and services to the public in an efficient and cost-effective manner.

The Secretary of Agriculture abolished the position of Under Secretary of Agriculture for Small Community and Rural Development and the agencies of FmHA, RDA, and REA. At the same time, all activities related to farm loans were transferred to the Farm Service Agency. Of the subcabinet positions ordered by the Secretary, the Under Secretary of Agriculture for Rural Economic and Community Development was established. This name was later shortened to ***Rural Development*** during fiscal year 1996. The following is a description of the services and activities over which the mission area has jurisdiction:

#### Rural Housing Service (RHS)

RHS is responsible for housing loan programs and grants formerly performed by FmHA and rural community facility loan programs formerly performed by RDA. Other related functions include hazard waste management allocated grants and the salaries and expenses account.

#### Rural Utilities Service (RUS)

RUS is responsible for electric and telephone loan programs, Rural Telephone Bank activities, and distance learning and medical link grants formerly performed by REA. RUS is also responsible for rural water and waste disposal loans and grants and other grants which include solid waste management and emergency community water assistance formerly performed by RDA. Other related functions include the Appalachian Regional Commission and Economic Development Administration allocated grants and the salaries and expenses account.

### Rural Business - Cooperative Service (RBS)

RBS is responsible for business and industry loan programs, assistance programs for cooperatives, and activities of the Agricultural Cooperative Service, all of which were formerly performed by RDA. RBS is also responsible for rural economic development loans and grants formerly performed by REA. Other related functions include rural business enterprise and rural technology and cooperative development grants, and the salaries and expenses account.

### New Programs

Beginning in fiscal year 1998 and in accordance with the provisions set forth in the Federal Agriculture Improvement and Reform Act of 1996, as amended, Public Law 104-127, the Rural Community Advancement Program (RCAP) was established. This account consolidates funding for the direct and guaranteed water and waste disposal loans, water and waste disposal grants, emergency community water assistance grants, solid waste management grants, direct and guaranteed community facility loans, community facility grants, direct and guaranteed business and industry loans, rural business enterprise grants, and rural business opportunity grants. Consolidating funding for these 12 loan and grant programs under RCAP provides greater flexibility to tailor financial assistance to applicant needs.

Beginning in fiscal year 1998 and in accordance with the Budget of the United States Government, the Rural Housing Assistance Grant account was established. This account consolidates funding for the following five housing grant programs: rural housing for domestic farm labor grant program, very low-income housing repair grant program, supervisory and technical assistance grant program, compensation for construction defects program, and rural housing preservation grant program. This consolidation provides more flexibility for distributing rural housing assistance.

### Administrative Convergence

As part of the 1993 reorganization, the Department of Agriculture has been consolidating the administrative organizations that provide support to program managers. Currently three separate administrative structures provide support to the Natural Resources Conservation Service, and the Farm and Foreign Agricultural Services and Rural Development mission areas - down from nine such organizations in 1993. It is necessary to continue the streamlining process by combining these three structures into one unit, and by delegating the authority to conduct most administrative functions to the state level, closer to the customer.

Reasons for continuing the streamlining process are as follows:

- ! A consolidated structure will deliver better services to our local customers and employees.
- ! A consolidated structure will provide for a new consistency in administrative policy.

- ! A consolidated structure will make better use of limited administrative resources.
- ! A more efficient administrative structure will help to preserve limited budget resources for program delivery.

The three administrative organizational units mentioned above will be combined into one structure - the Support Services Bureau. The consolidation includes both headquarters and field activities. On October 1, 1998, the new organization will be formed and a full delegation of authority will be given to state leaders and heads of unique program entities to make administrative decisions.

The mission area is responsible for 92 accounting entities of various compositions and sizes which are used to make various loans and grants. As of September 30, 1998, loan and grant obligations in the amount of \$8.9 billion were incurred.

### **C. Budgets and Budgetary Accounting**

The Federal Credit Reform Act of 1990 contained in the Omnibus Budget Reconciliation Act of 1990 provides that the Federal Credit Reform Act of 1990 shall apply to all new loans and grants made by the Federal Government after the date of the enactment of this Act. The Act also provides that the Federal Credit Reform Act of 1990 shall not apply to any loan or grant made by the Federal Government before the date of the enactment of this Act.

! The guaranteed loan financing account records the cash flows associated with guaranteed loan commitments made after FY 1991. Congress' annual appropriation bill limiting guaranteed loan commitments and their corresponding apportioned program subsidies serve to limit the dollar amount of obligations for new guaranteed loan commitments. Tracked cash flows include payments of default claims, receipts of fees on guaranteed loan commitments, collections on defaulted guaranteed loans and subsidy payments, and the reserve maintained to cover default payments. The disbursements for defaulted loans from the guaranteed financing account are financed through subsidies received from the program accounts, interest earned on the subsidy, and Treasury borrowings.

#### **D. Basis of Accounting**

Aided by studies and recommendations from the Financial Accounting Standards Advisory Board (FASAB), the Director of OMB and the Comptroller General published specific standards which constitute generally accepted accounting principles for the Federal Government and its component entities. This comprehensive set of accounting principles and standards must be followed by Federal entities. For those transactions deemed not addressed by FASAB pronouncements, accounting principles and standards published by authoritative standard-setting bodies and other authoritative sources shall be considered, depending upon their relevance in a particular set of circumstances.

Pre-Credit Reform and Post-Credit Reform nonfederal transactions are recorded on a cash accounting basis, except for the accrual of interest related to borrower loans; Federal transactions are recorded on an accrual accounting basis. Under the cash method, revenues are recognized when cash is received and expenses are recognized when they are paid. Budgetary accounting is also necessary to facilitate compliance with legal constraints and controls over the use of Federal funds.

All significant interfund and intrafund balances and transactions have been eliminated in the consolidation.

#### **E. Revenues and Other Financing Sources**

##### Revolving/Credit Funds:

Beginning in FY 1992, the Balanced Budget Act of 1990, Title XIII of the Omnibus Budget Reconciliation Act of 1990, provides Credit Reform procedures which affected the financing of the revolving funds. Under Credit Reform, an appropriation is received in the year of loan-making sufficient to cover the subsidy cost of providing the loan. The subsidy cost is defined as the net present value, at the time of disbursement, of the difference between the Government's estimated cash disbursements for that loan and the Government's estimated cash inflows resulting from that loan (e.g., repayments of principal and interest, and other payments adjusted for estimated defaults, prepayments, fees, penalties, and other recoveries). Consequently, the implementation of Credit Reform has resulted in authorized appropriations which provide for

estimated future losses as opposed to reimbursement for losses appropriations which provided for past losses actually sustained prior to FY 1992. In addition to subsidy appropriations, the other sources of funding for the revolving funds include borrowings from Treasury and borrower loan repayments.

#### General Funds:

Appropriations are provided by Congress on both an annual and multi-year basis to fund certain general funds and other expenses such as personnel compensation and fringe benefits, rents, communications, utilities, other administrative expenses, and capital expenditures. The current budgetary process does not distinguish between capital and operating expenditures. For budgetary purposes, both are recognized as a use of budgetary resources as paid; however, for financial reporting purposes under accrual accounting, operating expenses are recognized currently while expenditures for capital and other long-term assets are capitalized and are not recognized as expenses until they are consumed during normal operations. Appropriations for general fund activities are recorded as a financing source when expended. Unexpended appropriations are recorded as Net Position (*Note 12*).

#### **F. Fund Balance with Treasury**

All receipts and disbursements are processed by the U.S. Treasury which, in effect, maintains the appropriate bank accounts.

#### **G. Escrow Disbursement Account**

With the implementation of the Centralized Servicing Center on October 1, 1996, the Rural Housing Service began collecting escrow payments (i.e., insurance and taxes) from new Single Family Housing borrowers. Existing borrowers, which were delinquent and required servicing actions, must also submit these escrow payments. These payments are deposited with the Trustee, Mercantile Bankcorporation. As Trustee, they are required to invest these funds and disburse them as stipulated in the Trust Agreement. The balance in this account as of September 30, 1998, is \$18.9 million. This amount has been included in the Consolidated Balance Sheet on the Cash and Other Monetary Assets and Trust and Deposit Liabilities lines.

#### **H. Direct Lending Activities**

Appropriated authority is received to make direct loans. These loans represent actual cash disbursements to borrowers which require repayment. Direct loans are only made if a borrower cannot secure adequate credit from other sources at reasonable rates and terms. Federal law provides for multiple servicing actions to assist financially troubled borrowers. The maintenance of detailed loan records consistent with the terms and conditions agreed upon with the borrower is required. The most significant of these actions include:

### Interest Credit Program:

The interest credit program provides for contractual agreements with single family and rural rental housing borrowers to reduce the borrowers' effective interest rate to as low as 1 percent. Single family housing borrowers currently receiving interest credit will continue to receive it for the initial loan and any subsequent loan as long as they are eligible and remain on interest credit. Borrowers' incomes will be reviewed annually to determine whether eligibility for this payment subsidy is still warranted.

### Payment Assistance:

This is a type of payment subsidy for single family housing borrowers who have never received interest credit or who have ceased receiving interest credit and at a later date again qualify for a payment subsidy. Borrowers' incomes will be reviewed annually to determine whether eligibility for this payment subsidy is still warranted.

Approximately \$1.2 billion of interest credit and payment subsidy were granted during fiscal year 1998.

### Moratorium:

A moratorium is a period of up to 2 years during which scheduled payments are deferred for payment at a later date. Borrowers may apply for a postponement of payments if, due to circumstances beyond their control, they are unable to continue making scheduled payments on the loan without unduly impairing their standard of living. As of September 30, 1998, there were 2,924 borrowers with a moratorium in effect.

### Delinquency Workout Agreements:

Borrowers with past due accounts may be offered the opportunity to avoid liquidation by entering into an agreement with RHS that specifies a plan for bringing the account current. To receive a delinquency workout agreement, the following requirements apply:

- ! A borrower who is able to do so will be required to pay the past-due amount in a single payment.
- ! A borrower who is unable to pay the past-due amount in a single payment must pay monthly all scheduled payments plus an agreed upon additional amount that brings the account current within 2 years or the remaining term of the loan, whichever is shorter.
- ! If a borrower becomes more than 30 days past due under the terms of a delinquency workout agreement, RHS may cancel the agreement.

As of September 30, 1998, there were 832 borrowers which had received delinquency workout agreements.

## **I. Guaranteed Lending Activities**

Other lending activities include the guaranteed loans for single family housing, multi-family housing, and community programs. The term “guarantee” means “to guarantee the repayment of loans originated, held, and serviced by a private financial agency or other lender approved by the Secretary of Agriculture”. Rural Development provides financial assistance to borrowers by guaranteeing loans made by federal or state chartered banks, savings and loan associations, cooperative lending agencies, or approved lending institutions who perform all loan servicing activities. Generally, the guaranteed loan program allows Rural Development to guarantee up to 90 percent of the money loaned by a financial institution (lender) to borrowers in rural areas or to businesses who employ people in rural areas.

Some guaranteed loans may be sold in the secondary market by the lender to an institution (referred to as a holder). However, all servicing responsibilities remain with the lender. Payments by the borrower are forwarded on a pro rata basis to the holder. If the holder does not receive payments on the note within 60 days of an installment due date, the holder can demand that Rural Development purchase the holder's share of the loan. When the loan is purchased, Rural Development assumes the rights of the holder and is entitled to the pro rata share of any payments made by the borrower to the lender. All guaranteed loans which are repurchased are treated as an asset (credit program receivables) in the portfolio (*Note 5*).

Lenders are required to inform Rural Development on the loan status of community program borrowers as of December 31 and June 30, and single family housing borrowers as of December 31, unless the loan is in default which requires more frequent reporting. If a borrower defaults on the loan, the lender is responsible for liquidating the collateral. After the proceeds of the sale have been applied to the outstanding balances, Rural Development is liable for losses under the terms of the guarantee.

Rural Development also provides financial assistance in the form of loan guarantees to rural electric and telephone utilities and cooperative and commercial borrowers for community antenna television services and facilities. However, no new financing has been provided since 1981 for the above-mentioned cooperative and commercial borrowers. Guaranteed loans are accounted for as contingent liabilities (*Note 5*).

## **J. Credit Program Receivables, Net Present Value**

Loans are accounted for as receivables after funds have been disbursed. They are carried at their principal amount outstanding (*Note 5*), and accrue interest daily based on the contractual interest rate. When a loan becomes nonperforming (in excess of 90 days delinquent or when borrowers enter into troubled debt restructuring arrangements), all interest previously accrued on the loan is reversed for financial reporting purposes, and interest income on the nonperforming loan is then recognized only to the extent of the collections received. Nonperforming loans are reclassified as performing and accrue interest when they become current or less than 90 days delinquent. In



addition, interest income recognition subsequent to troubled debt restructuring arrangements is generally limited to actual cash interest received from these borrowers.

Direct loans obligated prior to October 1, 1991, are reported at the present value of future cash flows. The provision calculation is based upon these projected cash flows discounted at the weighted-average rate of outstanding Treasury and Federal Financing Bank borrowings made prior to fiscal year 1992. Previously, it was based upon historical data (loan settlement data and acquired property data), current conditions, and an analysis of borrowers' financial condition.

The weighted-average discount rate used in determining the net present value of single family housing loans was 10.358%, multiple family housing loans was 10.358%, community facility and water and waste loans was 13.651%, electric loans was 5.706%, telephone loans was 3.901%, and RTB loans was 8.055%. The weighted-average borrower rates on these loans were 6.11%, 3.09%, 5.550%, 5.881%, 4.781%, and 7.101%, respectively.

The liability for loan guarantees for guaranteed loans obligated prior to October 1, 1991, are reported at the present value of future cash flows. The provision calculation is based upon these future cash flows (i.e., expectations of loan losses and an estimate of interest assistance payments to be made on guaranteed loans) discounted at the average interest rate of U.S. Treasury interest-bearing debt. The estimate is reported as an expense, and a corresponding accrual for estimated losses on loan guarantees is reported as a liability on the Consolidated Balance Sheet. The discount rate used in determining the net present value of single family housing guaranteed loans was 5.50%; business and industry, community facility, and water and waste guaranteed loans was 5.375%.

The projected cost of direct loan and guaranteed loan defaults (for loans obligated prior to October 1, 1991) will not necessarily reflect Rural Development's future appropriation requests. To the extent that revolving fund revenues are not sufficient to fund future costs, financing will have to be obtained from future appropriations, or other congressionally approved sources. For direct loans obligated on or after October 1, 1991, Rural Development recognizes these as assets at the present value of their estimated net cash inflows. The difference between the outstanding principal of the loans and the present value of their net cash inflows is recognized as a subsidy cost allowance. For guaranteed loans obligated on or after October 1, 1991, the present value of estimated net cash outflows of the loan guarantees is recognized as a liability. However, this liability is recognized at the time of obligation rather than at the time of loan disbursement as required by accounting standards.

## **K. Investments**

In fiscal year 1987, a loan asset sale was conducted as required in the Omnibus Budget Reconciliation Act of 1986. As a result of these sales, residual investments were maintained in the securities. A description of these investments is included in *Note 7*.

## **L. Property and Equipment**

The land, buildings, and equipment in the current operating environment is provided by the General Services Administration, who charges a Standard Level Users Charge that approximates the commercial rental rates for similar properties. Under Credit Reform all equipment purchases are made through the Salaries and Expense Fund. Equipment purchased after February 1994 is capitalized at cost if the initial cost is \$5000 or more. Prior to that, equipment was capitalized at cost if the initial cost was \$1000 or more. Currently, equipment costing less than \$5000 is expensed when purchased. Equipment is depreciated using the straight line method.

## **M. Liabilities**

Liabilities represent the amount of monies or other resources that are likely to be paid as the result of a transaction or event that has already occurred. However, no liability can be paid absent an appropriation. Where an appropriation has not been enacted, liabilities are considered not covered by budgetary resources. There is no certainty that appropriations will be enacted. Also, liabilities arising from other than contracts can be abrogated by the Government, acting in its sovereign capacity.

## **N. Borrowings/Interest Payable to the Treasury**

Borrowings payable to the Treasury result from the Secretary of Agriculture's authority to make and issue notes to the Secretary of the Treasury for the purpose of discharging obligations for the revolving funds. These revolving funds make periodic principal and interest payments to Treasury in accordance with established agreements.

## **O. Resources Payable to Treasury/Receivable from Appropriations**

Rural Development consolidates all unobligated net resources of loans obligated prior to fiscal year 1992 as either a Receivable from Appropriations (negative equity) or Resources Payable to Treasury (positive equity). All other capital accounts were transferred to these accounts.

In previous years, the current year reestimates were calculated in the spring of the following fiscal year and included in that year's financial statements. In fiscal year (FY) 1997, selected cohort reestimates were calculated for FY 1997 and were included in the financial statements for FY 1997. Also, 1996 reestimates were calculated and included in the financial statements for FY 1997. FY 1998 reestimates were calculated and all FY 1997 reestimates were recalculated and both are included in the FY 1998 financial statements.

## **P. Leases**

For FY 1998, it was not practicable to disclose operating leases by year; however, required disclosure is planned for FY 1999.

## **Q. Contingencies**

The Rural Development mission area is a party in various legal actions and claims through the normal course of its operations. In the opinion of management and the USDA Office of the General Counsel, the ultimate resolution of these legal actions and claims will not materially affect the financial position or results of operations.

## **R. Intragovernmental Financial Activities**

The Rural Development mission area is an integral part of the operations of the U.S. Department of Agriculture (USDA) and may thus be subject to financial and managerial decisions and legislative requirements which are beyond the control of the Agency's management. Consequently, day-to-day operations may not be conducted as they would if Rural Development were a separate and independent entity.

Beginning in fiscal year 1998, USDA will provide mission areas with an allocation of departmental nonreimbursed appropriated costs to include in their financial statements. These costs will affect the statement of net cost, statement of changes in net position, and the statement of financing.

The consolidated financial statements are not intended to report the mission area's proportionate share of the Federal deficit or of public borrowing, including interest thereon. Financing for budget appropriations could derive from tax revenues or public borrowing or both; the ultimate source of this financing, whether from tax revenues or public borrowing, has not been specifically allocated to Rural Development.

The majority of employees participate in the Civil Service Retirement System (CSRS), to which Rural Development makes matching contributions equal to 7 percent of pay. Rural Development does not report CSRS assets, accumulated plan benefits, or unfunded liabilities, if any, applicable to its employees. Reporting of such amounts is the responsibility of the Office of Personnel Management.

On January 1, 1987, the Federal Employees Retirement System (FERS) went into effect pursuant to Public Law 99-335. Most employees hired after December 31, 1983, are automatically covered by FERS and Social Security. Employees hired prior to January 1, 1984, can elect to either join FERS and Social Security or remain in CSRS. A primary feature of FERS is that it offers a savings plan to which the agencies automatically contribute 1 percent of pay and matches any employee contribution up to an additional 4 percent of pay.

Agency and matching contributions to retirement programs during fiscal year 1998 was approximately \$32 million.

Annual leave is accrued as it is earned and the accrual is reduced as leave is taken. Each year, the balance in the accrued annual leave account is adjusted to reflect current pay rates. To the extent current or prior year appropriations are not available to fund annual leave earned but not taken, funding will be obtained from future financing sources. Sick leave and other types of nonvested leave are expensed as taken.

**NOTE 2: FUND BALANCE WITH TREASURY**

	<b>Assets for Use By Entity</b>	<b>Assets Not for Use By Entity</b>	<b>Total</b>
	(Dollars in Thousands)		
Revolving Funds	\$ 2,063,763	\$ 0	\$ 2,063,763
Appropriated Funds	<u>4,415,593</u>	<u>0</u>	<u>4,415,593</u>
Total Fund Balance with Treasury	<u>\$ 6,479,356</u>	<u>\$ 0</u>	<u>\$ 6,479,356</u>

**NOTE 3: CASH AND OTHER MONETARY ASSETS**

	<b>Assets For Use By Entity</b>	<b>Assets Not For Use By Entity</b>	<b>Total</b>
	(Dollars in Thousands)		
Cash	<u>\$ 0</u>	<u>\$ 18,859</u>	<u>\$ 18,859</u>
Total Cash and Other Monetary Assets	<u>\$ 0</u>	<u>\$ 18,859</u>	<u>\$ 18,859</u>

See **Note 1G** for a description of this restricted cash.

**NOTE 4: ACCOUNTS RECEIVABLE**

	<b>Assets For Use By Entity</b>	<b>Assets Not For Use By Entity</b>	<b>Total</b>
	(Dollars in Thousands)		
<u>Federal</u>			
Salaries & Expenses	\$ 4,395	\$ 3	\$ 4,398
Total Federal	<u>\$ 4,395</u>	<u>\$ 3</u>	<u>\$ 4,398</u>
<u>Non-Federal</u>			
Guaranteed FFB Loans	\$ 610	\$ 0	\$ 610
Salaries and Expenses	108	46	154
Other	<u>46</u>	<u>0</u>	<u>46</u>
Total Non-Federal	<u>\$ 764</u>	<u>\$ 46</u>	<u>\$ 810</u>
Total Accounts Receivable	<u>\$ 5,159</u>	<u>\$ 49</u>	<u>\$ 5,208</u>

At this time, the establishment of an allowance for uncollectible amounts is deemed unnecessary.

## NOTE 5: CREDIT PROGRAM RECEIVABLES, NET PRESENT VALUE

*Loans Subject to Credit Reform:*

	<u>Loans Receivable, Gross</u>	<u>Interest Receivable, Gross</u>	<u>Foreclosed Property, Gross</u>	<u>Allowance for Credit Program Receivables (Present Value)</u>	<u>Credit Program Receivables, (Net Present Value)</u>
	(Dollars in Thousands)				
<b><i>Rural Housing</i></b>					
<b><i>Service:</i></b>					
RHIF	\$ 29,045,487	\$ 103,736	\$ 58,164	\$ (9,854,047)	\$ 19,353,340
RCFL	605,693	6,111	0	(68,939)	542,865
<b><i>Rural Utilities</i></b>					
<b><i>Service:</i></b>					
<b>RETRF:</b>					
Electric	28,423,425	15,573	0	(3,454,941)	24,984,057
Telephone	3,672,925	6,578	0	83,710	3,763,213
RTB	1,368,185	3,395	0	(197,877)	1,173,703
RWWDL	2,806,015	31,795	0	(527,913)	2,309,897
RDIF	3,828,845	48,530	0	(1,245,261)	2,632,114
RCDF	7,815	307	0	(1,093)	7,029
Other	3,317	90	0	0	3,407
<b><i>Rural Business and</i></b>					
<b><i>Cooperative</i></b>					
<b><i>Service:</i></b>					
RDLF	285,946	1,281	0	(130,271)	156,956
RBIL	26,144	835	0	(3,238)	23,741
REDS	53,780	0	0	(9,641)	44,139
Total	<u>\$ 70,127,577</u>	<u>\$ 218,231</u>	<u>\$ 58,164</u>	<u>\$ (15,409,511)</u>	<u>\$ 54,994,461</u>

This summary schedule is calculated from the detail amounts shown in the following sections and the last column total is readily traceable to the Consolidated Balance Sheet.

### Accounting Policy - Present Value Disclosures:

As previously discussed in *Note 1*, direct loans, defaulted guaranteed loans, and loan guarantees made prior to fiscal year 1992 are reported on a present value basis. Direct loans or loan guarantees made after fiscal year 1991, and the resulting direct loans or loan guarantees, are governed by the Federal Credit Reform Act of 1990. That Act provides that the present value of the subsidy costs (i.e., interest rate differentials, interest subsidies, delinquencies and defaults, fee offsets, and other cash flows) associated with direct loans and loan guarantees be recognized as a

cost in the year the loan or loan guarantee is made. The net present value of loans or defaulted guaranteed loans receivable at any point in time is the amount of the gross loan or defaulted guaranteed loans receivable less the present value of the subsidy at that time.

The credit program receivables, net present value or the value of assets related to direct loans is not necessarily representative of the proceeds which might be expected to be received if these loans were sold on the open market.

An analysis of loans receivable, defaulted guaranteed loans, liability for loan guarantees, and the nature and amounts of the subsidy associated with the loans and loan guarantees are provided in the following sections.

**Direct Loans Obligated Prior to Fiscal Year 1992:**

	<u>Loans Receivable, Gross</u>	<u>Interest Receivable, Gross</u>	<u>Foreclosed Property, Gross</u>	<u>Allowance for Credit Program Receivables (Present Value)</u>	<u>Credit Program Receivables, (Net Present Value)</u>
	(Dollars in Thousands)				
<b><i>Rural Housing</i></b>					
<b><i>Service:</i></b>					
RHIF	\$ 19,651,678	\$ 75,916	\$ 43,100	\$ (7,356,632)	\$ 12,414,062
<b><i>Rural Utilities</i></b>					
<b><i>Service:</i></b>					
RETRF:					
Electric	24,029,600	14,839	0	(3,087,008)	20,957,431
Telephone	2,873,556	6,366	0	125,721	3,005,643
RTB	1,171,290	3,311	0	(196,887)	977,714
RDIF	3,828,845	48,530	0	(1,245,261)	2,632,114
RCDF	7,815	307	0	(1,093)	7,029
Other	3,317	90	0	0	3,407
<b><i>Rural Business and Cooperative</i></b>					
<b><i>Service:</i></b>					
RDLF	77,119	321	0	(30,851)	46,589
REDS	3,490	0	0	(303)	3,187
Total	<u>\$ 51,646,710</u>	<u>\$ 149,680</u>	<u>\$ 43,100</u>	<u>\$ (11,792,314)</u>	<u>\$ 40,047,176</u>

**Direct Loans Obligated After Fiscal Year 1991:**

	<u>Loans Receivable, Gross</u>	<u>Interest Receivable, Gross</u>	<u>Foreclosed Property, Gross</u>	<u>Allowance for Credit Program Receivables (Present Value)</u>	<u>Credit Program Receivables, (Net Present Value)</u>
	(Dollars in Thousands)				
<i>Rural Housing</i>					
<i>Service:</i>					
RHIF	\$ 9,393,809	\$ 27,820	\$ 15,064	\$ (2,497,415)	\$ 6,939,278
RCFL	605,693	6,111	0	(68,939)	542,865
<i>Rural Utilities</i>					
<i>Service:</i>					
RETRF:					
Electric	4,393,825	734	0	(367,933)	4,026,626
Telephone	799,369	212	0	(42,011)	757,570
RTB	196,895	84	0	(990)	195,989
RWWDL	2,806,015	31,795	0	(527,913)	2,309,897
<i>Rural Business and</i>					
<i>Cooperative</i>					
<i>Service:</i>					
RDLF	208,827	960	0	(99,420)	110,367
RBIL	26,144	835	0	(3,238)	23,741
REDS	50,290	0	0	(9,338)	40,952
Total	<u>\$ 18,480,867</u>	<u>\$ 68,551</u>	<u>\$ 15,064</u>	<u>\$ (3,617,197)</u>	<u>\$ 14,947,285</u>



**Liability for Loan Guarantees:**

	<b>Liabilities For Pre-1992 Loan Guarantees (Present Value)</b>	<b>Liabilities for Post-1991 Loan Guarantees (Present Value)</b>	<b>Total Liabilities For Loan Guarantees (Present Value)</b>
	(Dollars in Thousands)		
<b><i>Rural Housing Service:</i></b>			
RHIF	\$ 3,733	\$ 202,555	\$ 206,288
RCFL	0	2,994	2,994
<b><i>Rural Utilities Service:</i></b>			
ELECTRIC	142,021	0	142,021
RWWDL	0	(1,115)	(1,115)
RDIF	7,074	0	7,074
<b><i>Rural Business and Cooperative Service:</i></b>			
RBIL	0	103,200	103,200
Army	0	188	188
Total	<u>152,828</u>	<u>307,822</u>	<u>460,650</u>

**Guaranteed Loans Outstanding:**

	<b>Pre-1992 Outstanding Guaranteed Principal (Face Value)</b>	<b>Post-1991 Outstanding Guaranteed Principal (Face Value)</b>	<b>Total Outstanding Guaranteed Principal (Face Value)</b>
--	---	--	--

(Dollars in Thousands)

***Rural Housing Service:***

RHIF	\$ 27,593	\$ 7,260,010	\$ 7,287,603
RCFL	0	155,997	155,997

***Rural Utilities Service:***

ELECTRIC	617,298	0	617,298
TELEPHONE	1,643	0	1,643
RWWDL	0	11,182	11,182
RDIF	194,326	0	194,326
RCDF	4,799	0	4,799

***Rural Business and  
Cooperative Service:***

RBIL	0	1,885,695	1,885,695
Army	0	10,000	10,000

Total	<u>\$ 845,659</u>	<u>\$ 9,322,884</u>	<u>\$ 10,168,543</u>
-------	-------------------	---------------------	----------------------

(Dollars in Thousands)

***Rural Housing Service:***

RHIF	\$ 23,758	\$ 6,485,555	\$ 6,509,313
RCFL	0	125,173	125,173

***Rural Utilities Service:***

ELECTRIC	617,298	0	617,298
TELEPHONE	1,643	0	1,643
RWWDL	0	8,905	8,905
RDIF	161,371	0	161,371
RCDF	4,291	0	4,291

***Rural Business and  
Cooperative Service:***

RBIL	0	1,483,054	1,483,054
Army	0	9,000	9,000

Total	<u>\$ 808,361</u>	<u>\$ 8,111,687</u>	<u>\$ 8,920,048</u>
-------	-------------------	---------------------	---------------------

**Subsidy Expense for Post-1991 Credit Program Receivables:**

Current Year's Direct Loans

	<u>Interest Differential</u>	<u>Defaults</u>	<u>Fees</u>	<u>Other</u>	<u>Total Current Year's Direct Loans</u>	<u>FY '98 Direct Loan Reestimates</u>	<u>Total Direct Loan Subsidy Expenses</u>
	(Dollars in Thousands)						
<i>Rural Housing</i>							
<i>Service:</i>							
RHIF	\$ 232,358	\$ 10,446	\$ (68,719)	\$ 38,485	\$ 212,570	\$ 71,579	\$ 284,149
RCFL	17,577	556	0	(1,410)	16,723	(12,189)	4,534
<i>Rural Utilities</i>							
<i>Service:</i>							
<i>RETRF:</i>							
Electric	46,223	6,963	0	0	53,186	(88,028)	(34,842)
Telephone	31,552	(15,129)	(1,331)	(7,473)	7,619	(20,139)	(12,520)
RTB	457	4	0	0	461	(13,964)	(13,503)
RWWDL	95,636	457	0	(3,310)	92,783	9,366	102,149
<i>Rural Business</i>							
<i>Service:</i>							
RDLF	21,488	0	0	0	21,488	(3,394)	18,094
RBIL	(882)	332	0	4	(546)	(1,729)	(2,275)
REDS	4,142	0	0	(166)	3,976	(1,169)	2,807
Total	<u>\$ 448,551</u>	<u>\$ 3,629</u>	<u>\$ (70,050)</u>	<u>\$ 26,130</u>	<u>\$ 408,260</u>	<u>\$ (59,667)</u>	<u>\$ 348,593</u>

The percentage rate used to break out the 4 components of subsidy is based on the reestimation rates for fiscal year 1998.

**Subsidy Expense for Post-1991 Loan Guarantees:**

Current Year's Loan Guarantees

	<u>Interest Supplement</u>	<u>Defaults</u>	<u>Fees</u>	<u>Other</u>	<u>Total Current Year's Loan Guarantees</u>	<u>FY '98 Loan Guarantee Reestimates</u>	<u>Total Loan Guarantee Subsidy Expenses</u>
	(Dollars in Thousands)						
<i>Rural Housing Service:</i>							
RHIF	\$ 2,626	\$ 9,491	\$ (4,645)	\$ 32	\$ 7,504	\$ 109,232	\$ 116,736
RCFL	0	(59)	162	0	103	(3,923)	(3,820)
<i>Rural Utilities Service:</i>							
RWWDL	0	236	(22)	(267)	(53)	(63)	(116)
<i>Rural Business Service:</i>							
RBIL	0	28,772	(15,897)	(2,550)	10,325	44,840	55,165
Army	0	0	96	0	96	0	96
Total	<u>\$ 2,626</u>	<u>\$ 38,440</u>	<u>\$ (20,306)</u>	<u>\$ (2,785)</u>	<u>\$ 17,975</u>	<u>\$ 150,086</u>	<u>\$ 168,061</u>

The percentage rate used to break out the 4 components of subsidy is based on the reestimation rates for fiscal year 1998.

## **Other Disclosures**

### **Foreclosed Property**

Property is acquired largely through foreclosure and voluntary conveyance. Acquired properties associated with pre-1992 and post-1991 loans are reported at their market value at the time of acquisition. The projected future cash flows associated with acquired properties are used in determining the related allowance (at present value). As of September 30, 1998, Rural Housing Service properties consist primarily of 1,061 rural single family dwellings. The average holding period for single family housing properties in inventory for fiscal year 1998 was 13.8 months. The approximate number of borrowers for which foreclosure proceedings were in process at the end of fiscal year 1998 was 11 thousand. Certain properties can be leased to eligible individuals.

### **Other**

The unpaid principal balance of nonperforming loans as of September 30, 1998, was 1.5 billion. If interest had been reported on these nonperforming loans, instead of reported only to the extent of the collections received, interest income would have increased by \$77 million to a total of \$3.8 billion during fiscal year 1998 and \$270 million during the entire delinquency. Approximately \$20.1 billion of the Rural Housing Service unpaid loan principal as of September 30, 1998, was receiving interest credit. If those loans receiving interest credit had interest accrued at the full unreduced rate, interest income would have been approximately \$1.2 billion higher for fiscal year 1998. As of September 30, 1998, the Rural Development portfolio contained approximately 92 thousand restructured loans with an outstanding unpaid principal balance of \$7.6 billion.

The financial strength of Generation and Transmission Cooperative (G&T) borrowers depends in part on the long term, all-requirements wholesale power contracts between the G&T and its distribution members. The contracts, which are pledged to the government and the G&T's other secured lenders, provide revenues necessary for the G&T to meet its operating costs and repay indebtedness. A 7th Circuit Court of Appeals decision regarding the assignability of such contracts could, if followed by other courts, affect the value of the contracts as security under certain circumstances including the bankruptcy of a G&T. Management believes that the contracts will be upheld in the future and that there will be no material impact to the financial condition of the agency.

**NOTE 6: GENERAL PROPERTY, PLANT, AND EQUIPMENT, NET**

This equipment generally represents computer hardware, software, and other office equipment used in the Rural Development mission area's network of offices.

<u>Classes of Fixed Assets</u>	<u>Depreciation Method *</u>	<u>Service Life (Years)</u>	<u>Acquisition Value</u>	<u>Accumulated Depreciation</u>	<u>Book Value</u>
(Dollars in Thousands)					
Equipment	SL	1-10	\$ 11,963	\$ (6,355)	\$ 5,608
ADP Software	SL	5	3,192	(46)	3,146
Total			<u>\$ 15,155</u>	<u>\$ (6,401)</u>	<u>\$ 8,754</u>

**\* SL - Straight Line**

**NOTE 7: OTHER ASSETS**

*Amounts are presented in thousands of dollars.*

***Other Assets For Use By Entity***

Non-Federal

Investment in Loan Asset Sale Trust *	\$ 54,615
Other	92
Total Non-Federal	<u>\$ 54,707</u>
Total Other Assets For Use By Entity	<u>\$ 54,707</u>
Total Other Assets	<u><u>\$ 54,707</u></u>

- \* In fiscal year 1987, a loan asset sale was conducted as required in the Omnibus Budget Reconciliation Act of 1986 (Public Law 99-509). As a result of these sales, the Rural Development Insurance Fund (RDIF) and the Rural Housing Insurance Fund (RHIF) maintain investments in the Class C securities of the Community Program Loan Trust, 1987A, and the Rural Housing Trust, 1987-1, respectively. These investments represent a residual security in the respective Trust and entitles Rural Development to residual cash flows resulting from loan repayments not required to pay trust security holders or to fund required reserves. Rural Development intends to retain the RDIF and RHIF Class C investments into the foreseeable future.

## NOTE 8: STOCK PAYABLE TO RTB BORROWERS

	<u>Current</u>	<u>Non-Current</u>	<u>Total</u>
	(Dollars in Thousands)		
<u>Non-Federal</u>			
B Stock Payable	\$ 0	\$ 532,542	\$ 532,542
C Stock Payable	<u>0</u>	<u>\$ 210,487</u>	<u>210,487</u>
Total	<u>\$ 0</u>	<u>\$ 743,029</u>	<u>\$ 743,029</u>

These liabilities are covered by budgetary resources.

### Capital Stock Class B:

Class B stock, a voting class of stock, is issued only to borrowers of RTB, in proportion to actual loan advances. RTB requires borrowers to purchase Class B stock in the amount of 5 percent of advanced loan amounts. Class B stock is nontransferable, except in connection with a transfer of ownership, approved by RTB, of all or part of a RTB loan. A borrower, upon retiring all debt with RTB, may exchange Class B stock for Class C stock. Otherwise, the borrower retains possession of the stock.

### Capital Stock Class C:

Class C stock, a voting class of stock, is issued only to RTB borrowers, or to corporations and public entities eligible to borrow from RTB under Section 408 of the Rural Electrification Act of 1936, as amended, or by organizations controlled by such borrowers, corporations, and public entities.

For further details regarding Class B & C Stock, see **Note 7, Net Position**, in the Rural Telephone Bank Financial Statements which is issued under separate cover.

## NOTE 9: DEBT

	<u>Beginning Balance</u>	<u>New Borrowings</u>	<u>Repayments</u>	<u>Ending Balance</u>
	(Dollars in Thousands)			
<u>Agency Debt</u>				
<i>Interest Bearing:</i>				
Held by the Public	\$ 13,551	\$ 0	\$ (796)	\$ 12,755
Notes Payable	<u>2,156,616</u>	<u>0</u>	<u>(1,349,582)</u>	<u>807,034</u>
Total Agency Debt	<u>\$ 2,170,167</u>	<u>\$ 0</u>	<u>\$ (1,350,378)</u>	<u>\$ 819,789</u>
<u>Other Debt</u>				
<i>Interest Bearing:</i>				
Debt to the Treasury	\$ 13,196,781	\$ 2,456,932	\$ (515,645)	\$ 15,138,068
Debt to the Federal Financing Bank (FFB)	<u>36,622,728</u>	<u>389,398</u>	<u>(5,071,457)</u>	<u>31,940,669</u>
Total	<u>\$ 49,819,509</u>	<u>\$ 2,846,330</u>	<u>\$ (5,587,102)</u>	<u>\$ 47,078,737</u>
<i>Non-Interest Bearing:</i>				
Debt to the Treasury	<u>\$ 6,562,330</u>	<u>\$ 0</u>	<u>\$ (394,500)</u>	<u>\$ 6,167,830</u>
Total	<u>\$ 6,562,330</u>	<u>\$ 0</u>	<u>\$ (394,500)</u>	<u>\$ 6,167,830</u>
Total Other Debt	<u>\$ 56,381,839</u>	<u>\$ 2,846,330</u>	<u>\$ (5,981,602)</u>	<u>\$ 53,246,567</u>
Total Debt	<u>\$ 58,552,006</u>	<u>\$ 2,846,330</u>	<u>\$ (7,331,980)</u>	<u>\$ 54,066,356</u>
<u>Classification of Debt</u>				
Federal		\$ 53,246,567		
Non-Federal			819,789	
Total		<u>\$ 54,066,356</u>		

Agency and other debt is covered by budgetary resources. The outstanding debt, as of September 30, 1998, for RHS, RUS, and RBS follows: \$17.3 billion, \$36.6 billion, and \$.2 billion, respectively.

Borrowings from the FFB are either in the form of Certificates of Beneficial Ownership (CBO) or loans executed directly between the borrower and FFB with Rural Development unconditionally guaranteeing repayment. Borrowings from private investors are in the form of CBO's. CBO's outstanding with the FFB and private investors are generally secured by unpaid loan principal balances. CBO's outstanding are related to pre-Credit Reform loans and are no longer used for program financing.



FFB CBO's are repaid as they mature and are not related to any particular group of loans. Borrowings made to finance loans directly between the borrower and FFB mature and are repaid as the related group of loans becomes due. Interest rates on the related group of loans are equal to interest rates on FFB borrowings, except in those situations in which an FFB-funded loan is restructured and the terms of the loan are modified. During fiscal year 1998, approximately \$2.1 billion of FFB loans were repriced or refinanced.

In conjunction with certain RUS troubled debt restructurings, Rural Development has assumed notes payable to non-federal entities approximating \$807 million for debt previously guaranteed. A substantial portion of these balances are owed to the National Rural Utilities Cooperative Finance Corporation, a private lender to rural electric borrowers. The notes bear interest at rates ranging from 7.13 to 10.70 percent, and mature through the year 2022.

Supplemental information associated with fiscal year 1998 debt follows:

*Amounts are presented in thousands of dollars.*

**Interest Payable, Federal**

Federal Financing Bank	\$ 726,344
U.S. Treasury	<u>1,403</u>
Total	<u>\$ 727,747</u>

**Interest Expense, Federal**

Federal Financing Bank	\$ 3,524,409
U.S. Treasury	<u>1,285,486</u>
Total	<u>\$ 4,809,895</u>

**NOTE 10: ACCRUED PROGRAM LIABILITIES**

*Amounts are presented in thousands of dollars.*

Non-Federal

Accrued Payroll and Benefits	\$ 19,052
Total Non-Federal	<u>\$ 19,052</u>
Total Accrued Program Liabilities	<u><u>\$ 19,052</u></u>

These liabilities are covered by budgetary resources.

**NOTE 11: OTHER LIABILITIES**

	<u>Current</u>	<u>Non-Current</u>	<u>Total</u>
	(Dollars in Thousands)		
<u>Non-Federal</u>			
Dividends Payable	\$ 14,362	\$ 0	\$ 14,362
Other	<u>0</u>	<u>14,157</u>	<u>14,157</u>
Total Non-Federal	<u>\$ 14,362</u>	<u>\$ 14,157</u>	<u>\$ 28,519</u>
Total Other Liabilities	<u><u>\$ 14,362</u></u>	<u><u>\$ 14,157</u></u>	<u><u>\$ 28,519</u></u>

These liabilities are covered by budgetary resources.

**NOTE 12: NET POSITION**

*Amounts are presented in thousands of dollars.*

Unexpended Appropriations

Unobligated, Available	\$ 256,021
Undelivered Orders	<u>4,068,804</u>
Total Unexpended Appropriations	<u><u>\$ 4,324,825</u></u>

Capital Stock Class A:

Rural Development owns all Class A stock on behalf of the United States Government and any cash dividends are paid to the U.S. Treasury. Public Laws 92-12 and 97-98 authorized Congress, in fiscal years 1971 through 1991, to appropriate no more than \$30 million per year for the purchase of RTB Class A stock a nonvoting class of stock. Class A stock has a guaranteed annual dividend of 2 percent of the total funds received. The law provides that Congress annually appropriate funds until such purchases approximate \$600 million. As of September 30, 1998, RTB Class A stock appropriations amounted to \$592.1 million. No future appropriations are anticipated. Beginning in 1996, RTB is required to repurchase this stock from Rural Development; however, in accordance with Public Law 105-86, the maximum Class A stock that may be retired is 5 percent. According to enabling legislation and amendments, the Bank will be converted to independent status when 51 percent of the Class A stock issued to the United States has been fully redeemed and retired. On September 30, 1998, in accordance with Bank Board resolution 98-5, the third redemption of Class A stock, in the amount of \$27.8 million occurred, leaving a balance of \$528.2 million outstanding, which has been eliminated in consolidation.

Unexpended Appropriations:

Unexpended Appropriations include the undelivered orders and unobligated balances of the general funds and the program accounts which receive Congressional appropriations through the budgetary process.

As appropriated funds incur obligations, the obligated amount is recorded as an undelivered order. Undelivered orders are reduced by either an expenditure or an obligation cancellation. Appropriated funds which are not obligated are treated as unobligated amounts. At the end of the fiscal year, certain multi-year appropriations which have unobligated balances remain available for obligation in future periods. Unobligated appropriations are returned to the U.S. Treasury when their period of availability expires.

Cumulative Results of Operations:

Due to the FY 1998 implementation of Statement of Federal Financial Accounting Standard No. 7, Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting, equity accounts formerly shown as Future Funding Requirements and Invested Capital were closed to Cumulative Results of Operations and are no longer presented separately on the Balance Sheet. The amounts closed to Cumulative Results of Operations were \$62,600 thousand and \$56,595 thousand, respectively. Because these amounts were included in the determination of Net Position for FY 1997, there are no retroactive effects on Net Position due to this change.

## **NOTE 13: COMMITMENTS AND CONTINGENCIES**

As of September 30, 1998, unliquidated loan and grant obligations (undelivered orders) were \$13 billion.

Interest Guarantees (\$91 million) and Loan Guarantees (\$8.9 billion) are accounted for as contingent liabilities. The face value of the loan guarantees is provided in **Note 5**.

As of September 30, 1998, the amount of commitments to extend loan guarantees was \$2.3 billion.

As of September 30, 1998, there were no obligations due to cancelled appropriations for which there is a contractual commitment for payment.

**SUPPORTING SCHEDULES FOR THE STATEMENT OF NET COST**

<b>COSTS (NOTE: 14)</b>	<b><u>Mortgage Credit</u></b>	<b><u>Housing Assistance</u></b>	<b><u>Community Development</u></b>	<b><u>Area &amp; Regional Development</u></b>
Program Costs:				
Federal	\$ 2,338,049	\$ 0	\$ 10,687	\$ 973,740
Non-Federal:				
Grants and Transfers:				
Grants and Payments	45,639	563,846	442,904	49,922
Loan Subsidy Costs	400,885	0	155,637	7,398
Other Program Costs	<u>616,861</u>	<u>0</u>	<u>(25)</u>	<u>201,221</u>
Total Program Production Costs	\$ 3,401,434	\$ 563,846	\$ 609,203	\$ 1,232,281
Less Earned Revenues	<u>(2,202,643)</u>	<u>0</u>	<u>0</u>	<u>(971,173)</u>
Excess Production Costs Over Revenues	<u>\$ 1,198,791</u>	<u>\$ 563,846</u>	<u>\$ 609,203</u>	<u>\$ 261,108</u>
Net Program Costs	<u>\$ 1,198,791</u>	<u>\$ 563,846</u>	<u>\$ 609,203</u>	<u>\$ 261,108</u>
Cost Not Assigned to Programs				
<b>NET COST OF OPERATIONS</b>	<b><u><u>\$ 1,198,791</u></u></b>	<b><u><u>\$ 563,846</u></u></b>	<b><u><u>\$ 609,203</u></u></b>	<b><u><u>\$ 261,108</u></u></b>

**SUPPORTING SCHEDULES FOR THE STATEMENT OF NET COST**

<b>COSTS (NOTE: 14)</b>	<u><b>Energy Supply &amp; Conservation</b></u>	<u><b>Department of Defense - Military</b></u>	<u><b>Water Resources</b></u>	<u><b>Conservation and Land Management</b></u>
Program Costs:				
Federal	\$ 2,133,824	\$ 0	\$ 0	\$ 0
Non-Federal:				
Grants and Transfers:				
Grants and Payments	(42)	0	0	0
Loan Subsidy Costs	(47,362)	96	0	0
Other Program Costs	<u>(1,375,699)</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total Program Production Costs	\$ 710,721	\$ 96	\$ 0	\$ 0
Less Earned Revenues	<u>(2,358,574)</u>	<u>0</u>	<u>(143)</u>	<u>0</u>
Excess Production Costs Over Revenues	\$ (1,647,853)	\$ 96	\$ (143)	\$ 0
Net Program Costs	<u>\$ (1,647,853)</u>	<u>\$ 96</u>	<u>\$ (143)</u>	<u>\$ 0</u>
Costs Not Assigned to Programs				
<b>NET COST OF OPERATIONS</b>	<u><u>\$ (1,647,853)</u></u>	<u><u>\$ 96</u></u>	<u><u>\$ (143)</u></u>	<u><u>\$ 0</u></u>

**SUPPORTING SCHEDULES FOR THE STATEMENT OF NET COST**

	<u>Pollution Control and Abatement</u>	<u>Agricultural Research and Services</u>	<u>Intra-Agency Eliminations</u>	<u>Consolidated Total</u>
<b>COSTS (NOTE: 14)</b>				
Program Costs:				
Federal	\$ 0	\$ 0	\$ (440,845)	\$ 5,015,455
Non-Federal:				
Grants and Transfers:				
Grants and Payments	54	44		1,102,367
Loan Subsidy Costs	0	0		516,654
Other Program Costs	<u>0</u>	<u>0</u>		<u>(557,642)</u>
Total Program Production Costs	\$ 54	\$ 44	\$ (440,845)	\$ 6,076,834
Less Earned Revenues	<u>0</u>	<u>0</u>	440,845	<u>(5,091,688)</u>
Excess Production Costs Over Revenues	\$ 54	\$ 44	\$ 0	\$ 985,146
Net Program Costs	<u>\$ 54</u>	<u>\$ 44</u>	<u>\$ 0</u>	<u>\$ 985,146</u>
Costs Not Assigned to Programs				<u>13,956</u>
<b>NET COST OF OPERATIONS</b>	<u><u>\$ 54</u></u>	<u><u>\$ 44</u></u>	<u><u>\$ 0</u></u>	<u><u>\$ 999,102</u></u>

**OTHER DISCLOSURES**

The list below contains budget functional classification codes and titles used in preparing the Statement of Net Cost and the related footnote.

<b>FUNCTION LEVEL TITLE</b>	<b>SUB FUNCTION LEVEL TITLE</b>	<b>BUDGET FUNCTIONAL CLASSIFICATION CODE</b>
National Defense	Department of Defense - Military	051
Energy	Energy Supply & Conservation	271,272
Natural Resources	Water Resources	301
	Conservation & Land Management	302
	Pollution Control & Abatement	304
Agriculture	Agricultural Research & Services	352
Commerce & Housing	Mortgage Credit	371
Community & Regional Development	Community Development	451
	Area & Regional Development	452
Education & Training	Elementary, Secondary, & Vocational Education	501
Income Security	Housing Assistance	604

USDA and the individual agencies preparing their own financial statements are required to prepare the Statement of Net Cost at the subfunction level. The Statement of Net Cost, as prepared by the Department of Treasury for the U.S. Government, shows these activities at the function level.



**NOTE 15: EARNED REVENUES**

*Amounts are presented in thousands of dollars.*

	<u>MORTGAGE CREDIT</u>	<u>AREA &amp; REGIONAL DEVELOPMENT</u>	<u>ENERGY SUPPLY &amp; CONSERVATION</u>	<u>OTHER</u>	<u>INTRA- AGENCY ELIMINATIONS</u>	<u>TOTAL</u>
<u>Non-Federal</u>						
Interest Revenue	\$ 1,431,650	\$ 480,802	\$ 1,859,941	\$ 143	\$ 0	\$ 3,772,536
Other	756	8,357	15	0	0	9,128
Total Non-Federal	<u>\$ 1,432,406</u>	<u>\$ 489,159</u>	<u>\$ 1,859,956</u>	<u>\$ 143</u>	<u>\$ 0</u>	<u>\$ 3,781,664</u>
<u>Federal</u>						
Interest Revenue - Subsidy	\$ 277,439	\$ 370,707	\$ 394,658	\$ 0	\$ 0	\$ 1,042,804
Interest Revenue from Treasury	67,058	96,749	42,868	0	0	206,675
Other	425,740	14,558	61,092	0	(440,845)	60,545
Total Federal	<u>\$ 770,237</u>	<u>\$ 482,014</u>	<u>\$ 498,618</u>	<u>\$ 0</u>	<u>\$ (440,845)</u>	<u>\$ 1,310,024</u>
Total Earned Revenues	<u>\$ 2,202,643</u>	<u>\$ 971,173</u>	<u>\$ 2,358,574</u>	<u>\$ 143</u>	<u>\$ (440,845)</u>	<u>\$ 5,091,688</u>

## **Other Disclosures**

### **Credit Reform**

The amount of subsidy expense on post-1991 direct loans equals the present value of estimated cash outflows over the life of the loan less the present value of cash inflows, discounted at the interest rate of marketable Treasury securities with a similar maturity term. A major component of subsidy expense is the interest subsidy cost/interest differential. This is defined as the excess of the amount of direct loans disbursed over the present value of the interest and principal payments required by the loan contracts, discounted at the applicable Treasury rate. One of the components of interest subsidy cost/interest differential is interest revenue. This interest revenue is earned from both federal and non-federal sources. For a further discussion of present value, refer to **Note 1J**, and for all of the components of subsidy expense and their respective dollar amounts by entity, refer to **Note 5**.

### **Exchange Transactions With Non-Federal Sources**

When a new direct loan program becomes a reality, the applicable public law normally addresses interest rates to be charged to borrowers in some fashion. Public laws can be specific, state a minimum and/or maximum rate, or in general terms. The following general discussion about borrower interest rates is in relation to loan programs within each of our mission areas.

**Rural Housing Service:** The two largest loan programs (single-family housing and rural rental & cooperative housing) have a statutory basis for rates that is not less than the current average market yield on outstanding U.S. marketable obligations of comparable maturities. This rate has been determined to be the 25 year Treasury rate.

**Rural Business-Cooperative Service:** The main loan program (business and industry) has a statutory basis for rate which is not less than the Treasury rate determined by considering 1) current average market yield on outstanding U.S. marketable obligations of comparable maturities, 2) comparable private market rates, 3) Secretary's insurance plus an additional charge to cover losses.

**Rural Utilities Services:** Water and Waste loans have a statutory basis for rate which has a range between less than or equal to 5% to not greater than the current market yield for outstanding municipal obligations of comparable maturities adjusted to the nearest 1/8 of 1%. Telephone loans have a statutory basis for rate that can range from a minimum of 5% to a rate not more than the rate applicable to other similar loans being made or purchased by the Federal Financing Bank. Electric loans have a statutory basis for rate that can range from a minimum which is equal to the current market yield on outstanding municipal obligations with remaining periods to maturity similar to the term selected by the applicant to a rate no greater than the rate applicable to other similar loans being made or purchased by the Federal Financing Bank.

### **Exchange Transactions With Federal Sources**

As the discussion in **Note 1B** attests, the history of Rural Development is one of financial and technical assistance to rural America. Rural Development serves as a temporary source of supervised credit until borrowers are able to qualify for private sector resources. As the lender of last resort, Rural Development is unable to recoup all of the costs associated with its loan making and loan servicing activities. The main reason is that the costs associated with borrowings from Treasury to make loans exceeds the interest income received from borrowers plus any interest income earned from Treasury.

### **NOTE 16: DISCLOSURES RELATED TO THE STATEMENT OF CHANGES IN NET POSITION**

*Amounts are in thousands of dollars.*

#### **Prior Period Adjustment:**

As the result of a recent review of the fiscal year 1997 Agriculture Appropriation Act, P.L. 104-180, 110 Stat 1598-1599, and consultation with the Office of General Counsel, it has been determined the income of the Rural Telephone Bank is entitled to earn interest on all cash balances maintained at Treasury. Therefore, the income of the Rural Telephone Bank was understated for Fiscal Year 1997 by \$9,647 thousand.

This adjustment is for interest earned on liquidating account balances which were credited to the Rural Telephone Bank by the U.S. Treasury, as of October 1, 1997.

## NOTE 17: DISCLOSURES RELATED TO THE STATEMENT OF BUDGETARY RESOURCES

*Amounts are presented in thousands of dollars.*

- ! The net amount of budgetary resources obligated for undelivered orders as of September 30, 1998, is \$13 billion.
- ! The amount of borrowing authority available as of September 30, 1998 is \$3.6 billion.
- ! *Requirements for repayments of borrowings:* Borrowings are repaid on form SF 1151, Nonexpenditure Transfer Authorization, as maturity dates become due. For liquidating accounts, maturity dates are one working day prior to the anniversary date of the note. For financing accounts, maturity dates are based on the period of time used in the subsidy calculation, not the contractual term of the agency's loans to borrowers. This period of time used in the subsidy calculation will normally be longer than the contractual term of the agency's loans to borrowers.

*Terms of borrowing authority used:* In general, borrowings are for periods of between one year and approximately fifty years depending upon the loan program/cohort. Interest rates on borrowings in the liquidating accounts were assigned on the basis of the Treasury rate in effect at the time of the borrowing. Interest rates on borrowings in the financing accounts are assigned on the basis of the Treasury rate in effect during the period of loan disbursements. Some individual loans are disbursed over several quarters or years. Consequently, several interest rates can be applicable to an individual loan. Thus, a single weighted average interest rate is maintained for each cohort and is adjusted each year until all the disbursements for the cohort have been made. Each year, the current average annual interest rate is weighted by current year disbursements and merged with the prior years weighted average to calculate a new weighted average.

Prepayments can be made on Treasury borrowings in the liquidating and financing accounts without penalty; however, they cannot be made on Federal Financing Bank Certificates of Beneficial Ownership in the liquidating accounts without penalty.

*Financing sources for repayments of borrowings:* Included are reestimates and cash flows (i.e., borrower loan principal repayments), appropriations received in liquidating accounts for "cash needs", residual unobligated balances, where applicable, and other Treasury borrowings.

! *Adjustments(in thousands of dollars) during the fiscal year to budgetary resources available at the beginning of the year are as follows:*

Actual Recoveries of Prior Year Obligations	\$ 879,300
Cancellations of Expired Accounts	(628,301)
Redemption of Debt	(6,009,403)
Other Authority Withdrawn	(1,195,582)
Total Adjustments	<u><u>\$ (6,953,986)</u></u>

Actual recoveries of prior year obligations represent cancellations or downward adjustments of obligations incurred in prior fiscal years that did not result in an outlay. For expired accounts, these recoveries are available for upward adjustments of valid obligations incurred during the unexpired period but not recorded.

Cancellations of expired accounts represent the amount of appropriation authority which is cancelled five years after the expiration of an annual or a multi-year appropriation.

Redemption of debt represents the amount of principal repayments paid to the Treasury or the Federal Financing Bank on outstanding borrowings. It does **not** include interest payments, which are shown as an obligation and an outlay.

Other authority withdrawn represents the withdrawal of unobligated balances of indefinite budget authority realized in no-year or multiple year accounts through downward adjustments of prior year obligations.

! *Existence, purpose, and availability of permanent indefinite appropriations:* Permanent indefinite appropriations are mainly applicable to liquidating accounts which have the ability to apportion them and for reestimates related to upward adjustments of subsidy in the program accounts. These appropriations become available pursuant to standing provisions of law without further action by Congress after transmittal of the Budget for the year involved. They are treated as permanent the first year they become available, as well as in succeeding years. However, they are not stated as specific amounts but are determined by specified variable factors, such as “cash needs” for the liquidating accounts and information about the actual performance of a cohort or estimated changes in future cash flows of the cohort in the program accounts.

The period of availability for these appropriations are as follows: Annual authority is available for obligation only during a specified year and expires at the end of that time. Multi-year authority is available for obligation for a specified period of time in excess of one fiscal year. No-year authority remains available for obligation for an indefinite period of time, usually until the objectives for which the authority was made available are achieved.

Annual and multi-year authority expire for the purpose of incurring new obligations. However, the authority is available for adjustments to obligations and for disbursements that were incurred or made during the period prior to expiration, but not recorded. Unless specifically authorized in law, the period that the expired authority is available for adjustments to obligations or for disbursements is five fiscal years (beginning with the first expired year). At the end of the fifth expired year, the authority is “cancelled”. Thereafter, the authority is not available for any purpose.

! *Legal arrangements affecting the use of unobligated balances of budget authority:* The availability/use of budgetary resources (i.e., unobligated balances) for obligation and expenditure are limited by purpose, amount, and time.

-- **Purpose** - Funds may be obligated and expended only for the purposes authorized the appropriations acts or other laws.

-- **Amount** - Obligations and expenditures may not exceed the amounts established in law. Amounts available are classified as either definite (i.e., not to exceed a specified amount) or indefinite (i.e., amount is determined by specified variable factors.)

-- **Time** - The period of time during which budgetary resources may incur new obligations is different from the period of time during which the budgetary resources may be used to disburse funds.

The time limitations on the use of unobligated balances are the same as those previously discussed in the last two paragraphs of the permanent indefinite appropriations footnote disclosure.

Any information about legal arrangements affecting the use of unobligated balances of budget authority will be specifically stated by program and fiscal year in the appropriation language or in the alternative provisions section at the end of the appropriations act.

## REQUIRED SUPPLEMENTARY INFORMATION

Amounts are presented in thousands of dollars.

	<b>Rural Community Advancement Program</b>	<b>Rural Electrification/ Telecommunication Funds</b>	<b>Rural Telephone Bank Funds</b>	<b>Rural Housing Funds</b>	<b>Rental Assistance Programs</b>
<b>Budgetary Resources</b>					
Budget Authority	\$ 1,455,344	\$ 2,343,123	\$ 132,326	\$ 5,629,770	\$ 624,362
Unobligated balances - beginning of period	343,088	415,718	286,924	159,079	5,273
Spending authority from offsetting collections	988,635	2,623,727	258,055	3,226,283	0
Adjustments	(122,066)	(1,555,271)	(72,190)	(5,048,358)	(81,649)
Total budgetary resources	<u>\$ 2,665,001</u>	<u>\$ 3,827,297</u>	<u>\$ 605,115</u>	<u>\$ 3,966,774</u>	<u>\$ 547,986</u>
<b>Status of Budgetary Resources</b>					
Obligations incurred	\$ 2,494,371	\$ 3,510,143	\$ 203,838	\$ 3,782,015	\$ 546,633
Unobligated balances-available	9,606	2	146	59,518	0
Unobligated balances-not available	161,024	317,152	401,131	125,241	1,353
Total, status of budgetary resources	<u>\$ 2,665,001</u>	<u>\$ 3,827,297</u>	<u>\$ 605,115</u>	<u>\$ 3,966,774</u>	<u>\$ 547,986</u>
<b>Outlays</b>					
Obligations incurred	\$ 2,494,371	\$ 3,510,143	\$ 203,838	\$ 3,782,015	\$ 546,633
Less: actual spending authority from offsetting collections and actual adjustments	(1,106,732)	(3,290,457)	(293,880)	(3,299,924)	(3,065)
Obligated balance, net - beginning of period	3,714,883	4,520,423	882,109	1,292,078	2,545,678
Less: obligated balance, net - end of period	(3,914,128)	(3,558,595)	(961,143)	(1,263,064)	(2,556,042)
Total outlays	<u>\$ 1,188,394</u>	<u>\$ 1,181,514</u>	<u>\$ (169,076)</u>	<u>\$ 511,105</u>	<u>\$ 533,204</u>

## REQUIRED SUPPLEMENTARY INFORMATION

Amounts are presented in thousands of dollars.

	<u>Rural Housing Grants</u>	<u>Salaries &amp; Expense</u>	<u>Other</u>	<u>Intra-Agency Eliminations</u>	<u>Consolidated Total</u>
<b>Budgetary Resources</b>					
Budget Authority	\$ 75,048	\$ 117,060	\$ 94,319	\$ 0	\$ 10,471,352
Unobligated balances - beginning of period	44,671	86,254	87,266	0	1,428,273
Spending authority from offsetting collections	0	445,113	43,306	(808,662)	6,776,457
Adjustments	<u>(12,841)</u>	<u>(23,511)</u>	<u>1,448</u>	<u>(39,548)</u>	<u>(6,953,986)</u>
Total budgetary resources	<u>\$ 106,878</u>	<u>\$ 624,916</u>	<u>\$ 226,339</u>	<u>\$ (848,210)</u>	<u>\$ 11,722,096</u>
<b>Status of Budgetary Resources</b>					
Obligations incurred	\$ 76,445	\$ 571,388	\$ 168,905	\$ (848,210)	\$ 10,505,528
Unobligated balances-available	2,464	178	17,154	0	89,068
Unobligated balances-not available	<u>27,969</u>	<u>53,350</u>	<u>40,280</u>	<u>0</u>	<u>1,127,500</u>
Total, status of budgetary resources	<u>\$ 106,878</u>	<u>\$ 624,916</u>	<u>\$ 226,339</u>	<u>\$ (848,210)</u>	<u>\$ 11,722,096</u>
<b>Outlays</b>					
Obligations incurred	\$ 76,445	\$ 571,388	\$ 168,905	\$ (848,210)	\$ 10,505,528
Less: actual spending authority from offsetting collections and actual adjustments	(1,769)	(451,705)	(56,434)	848,210	(7,655,756)
Obligated balance, net - beginning of period	82,420	117,562	248,784	0	13,403,937
Obligated balance, transferred, net	<u>(90,935)</u>	<u>(129,788)</u>	<u>(259,406)</u>	<u>0</u>	<u>(12,733,101)</u>
Total outlays	<u>\$ 66,161</u>	<u>\$ 107,457</u>	<u>\$ 101,849</u>	<u>\$ 0</u>	<u>\$ 3,520,608</u>