U.S. Department of Agriculture

Office of Inspector General
Financial & IT Operations

Audit Report

Rural Development's Financial Statements for Fiscal Years 2006 and 2005

Report No. 85401-13-FM
November 2006

UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250

November 9, 2006

REPLY TO
ATTN OF: 85401-13-FM

TO: Thomas C. Dorr
Under Secretary
for Rural Development

ATTN: John Dunsmuir
Acting Director
Financial Management Division

FROM: Robert W. Young /s/
Assistant Inspector General
for Audit

SUBJECT: Rural Development's Financial Statements for Fiscal Years 2006 and 2005

This report presents the results of our audits of Rural Development's financial statements for the fiscal years ending September 30, 2006 and 2005. The report contains an unqualified opinion 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 for implementation of 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.

Executive Summary

Rural Development's Financial Statements for Fiscal Years 2006 and 2005 (Audit Report No. 85401-13-FM)

Purpose

Our audit objectives were to determine whether (1) the financial statements present fairly, in all material respects, in accordance with generally accepted accounting principles, 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 objectives over financial reporting 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. We also determined that the information in the Management Discussion and Analysis was materially consistent with the information in the financial statements.

We conducted our audits at the Rural Development finance office and Centralized Servicing Center in St. Louis, Missouri, and the Rural Development national office in Washington, D.C. We also performed site visits to selected Rural Development field offices.

Results in Brief

In our opinion, the Rural Development consolidated financial statements for fiscal years 2006 and 2005, including the accompanying notes, present fairly in all material respects, financial position of Rural Development, as of September 30, 2006 and 2005; and its net costs, changes in net position, reconciliations of net costs to budgetary obligations, and budgetary resources, for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In our report on the Internal Control Structure Over Financial Reporting, we reported that improvements are needed in Rural Development's (1) information technology (IT), (2) credit reform processes, (3) unliquidated obligation process, and (4) liquidating methodology and subsidy allowance calculations.

We believe the IT weakness represents a material weakness. Our report on compliance with laws and regulations continues to disclose an instance of noncompliance related to the Federal Financial Management Improvement Act.

Key Recommendations

We did not make additional recommendations related to the IT weaknesses since those deficiencies and recommendations were documented in other Office of Inspector General reports.

We recommended that Rural Development improve its financial reporting controls over credit reform and unliquidated obligation accounting.

With regard to the liquidating methodology and subsidy allowance calculations, we recommended that the methodology be effectively implemented, including second party reviews of the results.

Agency Response

As discussed at the exit conference held on November, 7, 2006, Rural Development generally agreed with the findings and recommendations in this report.

Abbreviations Used in This Report

DLOS	Dedication Loan Origination and Servicing
FFMIA	Federal Financial Management Improvement Act
FFMSR	Federal Financial Management Systems Requirements
FMFIA	Federal Managers’ Financial Integrity Act
FSA	Farm Service Agency
IT	information technology
ITS	Information Technology Services
NIST	National Institute of Standards and Technology
NRCS	Natural Resources Conservation Services
OCIO	Office of the Chief Information Officer
OIG	Office of Inspector General
OMB	Office of Management and Budget
RHIF	Rural Housing Insurance Fund
SCA	Service Center Agencies
SFH	Single Family Housing
SP	Special Publication
ULO	Unliquidated Obligations
USDA	U.S. Department of Agriculture

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Report of the Office of Inspector General

To: Thomas C. Dorr
Under Secretary
for Rural Development

We have audited the accompanying consolidated balance sheets of Rural Development as of September 30, 2006 and 2005, and the related consolidated statements of net cost, changes in net position, financing, and the combined statements of budgetary resources for the fiscal years then ended (hereinafter referred to as the "consolidated financial statements"). The consolidated financial statements are the responsibility of Rural Development's management. Our responsibility is to express an opinion on the consolidated financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 06-03, "Audit Requirements for Federal Financial Statements." Those standards and OMB Bulletin No. 06-03 require that we plan and perform the audit to obtain reasonable assurance that the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above, present fairly, in all material respects, the financial position of Rural Development as of September 30, 2006 and 2005; and its net costs, changes in net position, reconciliation of net costs to budgetary obligations, and budgetary resources for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1C to the consolidated financial statements, during fiscal year 2006, no new Statements of Federal Financial Accounting Standards were implemented, as none were applicable or material.

The information in Management's Discussion and Analysis is not a required part of the consolidated financial statements, but is supplemental information required by accounting principles generally accepted in the United States of America or OMB Circular No. A-136, "Financial Reporting Requirements." We have applied certain limited procedures, consisting principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information and, accordingly, we express no opinion on it.

We have also issued a report on Rural Development's internal control over financial reporting and a report on the mission area's compliance with certain provisions of laws and regulations. These reports are an integral part of an audit performed in accordance with *Government Auditing Standards*, and, in considering the results of the audit, these reports should be read in conjunction with this report.

This report is intended solely for the information of the management of Rural Development, OMB, and Congress, and is not intended to be, and should not be, used by anyone other than these specified parties.

/s/

Robert W. Young
Assistant Inspector General
for Audit

November 7, 2006

Report of the Office of Inspector General on Internal Control Over Financial Reporting

To: Thomas C. Dorr
Under Secretary
for Rural Development

We have audited the accompanying consolidated balance sheets of Rural Development as of September 30, 2006 and 2005, and the related consolidated statements of net cost, changes in net position, financing, and the combined statements of budgetary resources for the fiscal years then ended (hereinafter referred to as the "consolidated financial statements") and have issued our report thereon dated November 7, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 06-03, "Audit Requirements for Federal Financial Statements."

In planning and performing our audit, we considered Rural Development's internal control over financial reporting by obtaining an understanding of the design effectiveness of internal controls, determining whether the internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 06-03 and *Government Auditing Standards*. We did not test all internal controls as defined by the Federal Managers' Financial Integrity Act of 1982. The objective of our audits was not to provide assurance on Rural Development's internal control. Consequently, we do not provide an opinion on internal control over financial reporting.

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 that, in our judgment, could adversely affect the agency's ability to meet the objectives of internal control. Material weaknesses are reportable conditions in which the design or operation of one or more internal control components do not reduce to a relatively low level the risk that misstatements, in amounts that would be material in relation to the consolidated financial statements being audited, or material to a performance measure or aggregation of related performance measures, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected. We noted certain matters described in the Findings and Recommendations, Sections 1 and 2, involving the internal control over financial reporting and its operation that we consider to be reportable conditions. We believe that the reportable condition in Section 1 is a material weakness.

Additional Other Procedures

As required by OMB Bulletin No. 06-03, we considered Rural Development's internal control over Required Supplemental Information by obtaining an understanding of the internal control, determining whether these internal controls had been placed in operation, assessing control risk, and performing tests of controls. Our procedures were not designed to provide assurance on internal control over such Required Supplemental Information; accordingly, we do not provide an opinion on such controls.

As further required by OMB Bulletin No. 06-03, with respect to internal control related to performance measures determined by management to be key and reported in the Management's Discussion and Analysis, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions and determined whether they had been placed in operation. Our procedures were not designed to provide assurance on internal control over reported performance measures; accordingly, we do not provide an opinion on such controls.

We did not identify any material weaknesses that were not disclosed in Rural Development's Federal Managers' Financial Integrity Act.

This report is intended solely for the information and use of the management of Rural Development, OMB, and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

/s/

Robert W. Young
Assistant Inspector General
for Audit

November 7, 2006

Report of the Office of Inspector General on Compliance with Laws and Regulations

To: Thomas C. Dorr
Under Secretary
for Rural Development

We have audited the consolidated balance sheets of Rural Development as of September 30, 2006 and 2005, and the related consolidated statements of net cost, changes in net position, financing, and the combined statement of budgetary resources for the fiscal years then ended (hereinafter referred to as the "consolidated financial statements") and have issued our report thereon dated November 7, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 06-03, "Audit Requirements for Federal Financial Statements."

The management of Rural Development is responsible for complying with laws and regulations applicable to it. As part of obtaining reasonable assurance about whether the consolidated financial statements are free of material misstatement, we performed tests of Rural Development's compliance with certain provisions of laws and regulations and Governmentwide policy requirements, noncompliance with which could have a direct and material effect on the determination of the consolidated financial statement amounts, and certain provision of other laws and regulations specified in OMB Bulletin No. 06-03, including certain requirements referred to in the Federal Financial Management Improvement Act of 1996 (FFMIA). We noted no reportable instances of noncompliance with these laws and regulations except as disclosed in this report. We limited our tests of compliance to the provisions described in the preceding sentence and did not test compliance with all laws and regulations applicable to Rural Development. However, providing an opinion on compliance with laws and regulations was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests and information brought to our attention during our audit disclosed no instances of reportable noncompliance with other laws and regulations discussed in the second paragraph of this report, exclusive of FFMIA, that are required to be reported under *Government Auditing Standards* and OMB Bulletin 06-03. (See Findings and Recommendations, Section 3.)

This report is intended solely for the information and use of the management of Rural Development, OMB, and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

/s/

Robert W. Young
Assistant Inspector General
for Audit

November 7, 2006

Material weaknesses are reportable conditions in which the design or operation of the internal control do not reduce to a relatively low level the risk that misstatements, in amounts that would be material in relation to the consolidated financial statements being audited, or material to a performance measure or aggregation of related performance measures, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected. We believe that Finding 1 is a material weakness.

Finding 1 Information Technology (IT) Internal Control Weaknesses Continue to Exist at Rural Development

IT Convergence at the Service Centers

In November 2004, the Office of the Chief Information Officer (OCIO)/Information Technology Services (ITS) agency was established to oversee the general support system for the co-located field offices of the Farm Service Agency (FSA), Natural Resources Conservation Service (NRCS), and Rural Development. A key element for the success of this Service Center Modernization Initiative is the replacement of aging business and technology systems through IT convergence, that will allow FSA, NRCS, and Rural Development, collectively referred to as the Service Center Agencies (SCA), to share data among themselves and their customers, and to streamline business processes.

The convergence process shifted the management and security responsibilities of the network operating environment from those individual SCAs to the Department's OCIO/ITS.

Overall, we found that ITS was beginning to implement controls over the weaknesses. Many of the control IT weaknesses identified were caused by a lack of communication and oversight among ITS and the SCAs throughout the convergence planning and implementation process. Consequently, the network and systems may be exploitable, jeopardizing the integrity of the SCAs' data and ITS' system resources.

We found that policies and procedures were lacking in some areas and/or were not being followed. The following summarizes the weaknesses we identified.

- Certification and accreditation documentation did not meet the Office of Management and Budget (OMB)[1] and National Institute of Standards and Technology (NIST)[2] guidance. Specifically, we found that security plans, risk assessments, contingency plans, and disaster recovery plans were not accurate and/or complete.

- Service Level Agreements between ITS and the SCAs did not meet Federal guidelines.

- ITS lacked adequate controls over software changes within the network.

- Backup/recovery procedures at the field sites we visited were inadequate and/or not tested.

- Vulnerability scanning of the ITS network was not operating effectively. Sites were not being scanned as required and vulnerabilities noted were not being timely remedied.

- ITS was unable to resolve reported security incidents in a timely manner.

- Physical and environmental controls were inadequate.

- Improvements were needed in obtaining adequate security clearances for ITS employees and contractors.

- ITS had not established and implemented policies and procedures for hardware maintenance activities at all sites.

- ITS had not ensured effective controls over computer equipment attached to the network by SCA partner organizations. Further, ITS had not maintained a record of the computer equipment connected under these partnership agreements.

- ITS policy governing user access to systems was not followed.

- An accurate inventory of equipment within ITS was not maintained.

[1] OMB Circular No. A-130, Appendix III, "Security of Federal Automated Information Resources," dated November 2000.
[2] NIST Special Publication (SP) 800-18, "Guide for Developing Security Plans for IT Systems," dated February 2006, and NIST SP 800-53, "Recommended Security Controls for Federal Information Systems," dated February 2005.

- Finally, ITS had not effectively ensured that system patches were consistently applied and documented.

Dedication Loan Origination and Servicing (DLOS) System

Rural Development uses the DLOS system to originate and service direct Single Family Housing (SFH) loans and grants, which accounted for over 378,000 loans with an outstanding principal balance of over $13 billion during fiscal year 2005. Servicing activities included payments received of over $1.1 billion. Overall, we found that Rural Development had not implemented adequate controls to adequately protect the integrity of the data. Ultimately, this may affect Rural Development's ability to adequately manage its SFH direct loan portfolio.

Management is responsible for developing and maintaining effective internal controls. The three objectives of internal control are to ensure the effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations. Appropriate internal control should be integrated into each system established by agency management to direct and guide its operations.[3] While Rural Development had implemented significant controls within the DLOS system, further improvements are needed. Specifically, weaknesses were noted with management oversight and documentation, system access controls, and application change controls.

We have concluded that IT weakness within Rural Development, taken as a whole, constitutes a material internal control weakness. As such, it was reported as substantial noncompliance in the agency's Federal Financial Managers' Integrity Act (FFMIA) report and as a Section 4 material weakness in its Federal Managers' Financial Integrity Act (FMFIA) report for fiscal year 2006.

[3] OMB Circular No. A-123, "Management's Responsibility for Internal Control," dated December 21, 2004.

Reportable conditions are matters coming to our attention that, in our judgment, should be communicated because they represent significant deficiencies in the design or operation of internal control, which could adversely affect the organization's ability to meet the objectives of internal control.

Finding 2 Improvements Needed In Credit Reform Quality Control Process

During fiscal year 2006, Rural Development modified its credit reform cash flow models. We recognize the significant efforts put forth by Rural Development during the fiscal year to review and improve in the information used to support the cash flow models and we commend Rural Development officials for those efforts. However, we identified deficiencies in Rural Development's credit reform processes related to the revision of its cash flow models and accuracy of data used in the models. We also identified errors in the related footnote disclosed initially provided by Rural Development. We attributed these conditions to a lack of adequate management oversight and/or second party reviews. As a result, additional Rural Development and OIG resources were expended to rework the calculations to correct the credit reform information contained in the financial statements and related disclosures.

Recommendation 1

Ensure that cash flow models, data inputs, estimates and reestimates, and related financial reporting are subject to appropriate controls, including management oversight review.

Finding 3 — Improvements Needed Over the Rural Telecommunications Program Unliquidated Obligations Certification Process

Rural Development continues to make improvements in its certification process of Rural Electric and Telecommunications Program unliquidated obligations (ULOs), however, additional improvements are necessary within the Telecommunications Program.[4] We reviewed a statistical sample of 57 Rural Electric and Telecommunications Program ULOs in the amount of $2.5 billion, of which 26 were telecommunications records with ULOs in the amount of $349 million. Our review disclosed that 2 of the 26 telecommunications records were improperly certified and should have been marked for deobligation in the certification reports. This condition occurred because Telecommunications Program officials did not timely contact borrowers to support certifications that the remaining ULOs were still needed. As a result, $69 million of the $98 million in Telecommunications Program ULOs identified by borrowers as needing rescission were not properly marked for deobligation. Further, Telecommunications Program officials did not timely contact borrowers to ensure $600 million in outstanding obligations from fiscal year 2001 and prior were valid.

The Department of Treasury's Fiscal Yearend 2006 Closing Procedures require agencies that have not reviewed their ULOs during the year to do so prior to yearend closing and to retain records on verifications to facilitate audits. Further, Departmental Regulation 2230-001, "Reviews of Unliquidated Obligations," dated April 17, 2002, states that the agency should review at fiscal yearend, all inactive ULOs over 2 years old and a dollar majority of inactive ULOs less than 2 years old based on a sample. In fiscal year 2006, Rural Development officials requested a waiver to Departmental Regulation 2230-001. Rural Development officials asserted that the certification procedures outlined in the regulation do not parallel program characteristics because Rural Electric and Telecommunications Program do not disburse their loan obligations in the first 2 years. The Office of the Chief Financial Officer granted Rural Development the waiver which changed the certification procedure to a 100 percent review of all ULOs over 3 years old regardless of activity status.

Telecommunications Program officials agreed to continue its efforts to contact borrowers and deobligate funds no longer needed. Specifically, Telecommunications Program officials stated they would send letters to all

[4] Certification reports are periodically provided to agencies which list their current outstanding obligations. Agencies are required to review these reports to determine whether the obligation is still needed to cover expected future outlays. If so, the obligation is considered to be valid. If not, the agency should deobligate the funds. The agencies should document this review and "certify" back to the Department that this was performed.

borrowers with loans that are more than 5 years old that have unadvanced balances.

Recommendation 2

Ensure borrowers are contacted sufficiently in advance of the certification process to obtain timely responses.

Recommendation 3

Ensure all Telecommunications ULOs included in the certification reports are adequately supported prior to certification.

Recommendation 4

Ensure all records identified by borrowers for rescission are deobligated and properly recorded prior to fiscal yearend.

Finding 4 Deficiencies Identified in Rural Development's Liquidating Methodology and Subsidy Allowance Calculations

During fiscal year 2004, Rural Development officials established a methodology to determine the present value of its liquidating fund based on the weighted average subsidy rate of the financing cohorts, which are substantially (90 percent) disbursed.

We identified deficiencies in Rural Development's process for calculating the present value of liquidating loans and the subsidy allowance for financing loans. These conditions occurred because Rural Development officials did not follow procedures as outlined in its liquidating allowance methodology, and second party reviews were either not performed or were inadequate.

Rural Development's allowance procedures state the reestimate rate, net obligations, and total disbursement amounts from the approximator process should be used in the liquidating allowance calculations.[5] Additionally, the calculated weighted average subsidy rate should be applied against the September 30 program balance to determine the allowance amount. We noted that:

[5] In order to comply with accelerated financial reporting deadlines, Rural Development revised its approach to performing the reestimates earlier using data prior to fiscal yearend. This is referred to as the approximator process.

- Rural Development officials used incorrect fiscal year 2006 reestimate rates in its calculation of weighted average subsidy rate for the liquidating Rural Housing Insurance Fund (RHIF). This occurred because of erroneous changes made to the SFH reestimates. As a result, the RHIF present value of liquidating loans was understated by approximately $12 million.

- Formula errors were identified in key fields of the Reestimate Worksheets for Guaranteed Business and Industry and SFH programs, resulting in inaccurate weighted average subsidy rates and subsidy allowance.

Recommendation 5

Develop a checklist for each program to ensure all procedures outlined in the methodology are performed. This should include the verification of formulas in key computed fields.

Recommendation 6

Ensure a documented second party review is performed for each program.

Section 3. Compliance With Laws and Regulations

The management of Rural Development is responsible for complying with applicable laws, regulations, and Governmentwide policy requirements, including noncompliance with laws and regulations disclosed by the audit, except for those instances in our judgment that are clearly inconsequential. As part of obtaining reasonable assurance about whether the consolidated financial statements are free of material misstatement, we performed tests of Rural Development compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of the consolidated financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 06-03, including certain requirements referred to in the FFMIA. For fiscal year 2006, we continue to report noncompliance with FFMIA.

Finding 5 Noncompliance With FFMIA Requirements

Rural Development initially reported that its internal controls were substantially compliant with Section 2 of the FMFIA Report, as of September 30, 2006. Rural Development reported that its financial management and accounting systems were substantially compliant with OMB Circular No. A-127, "Financial Management Systems." In addition, Rural Development reported in its FFMIA Remediation Plan, dated August 31, 2006, that its financial management systems were compliant with Federal Financial Management Systems Requirements.

We notified Rural Development that we disagreed with its assessments. On October 27, 2006, Rural Development revised its FMFIA and FFMIA certifications. Rural Development disclosed IT as a material weakness and stated that it could not provide reasonable assurance that internal controls were operating effectively under Section 4 of FMFIA. We concurred with that assessment. Rural Development modified its FFMIA and included substantial noncompliance for information security, policies, procedures, and practices. In accordance with OMB Bulletin No. 06-03 and Section 803(b) of the FFMIA, OIG is reporting that Rural Development's systems are not in compliance with FFMSR. The nature and extent of the noncompliance and the primary cause of the noncompliance are discussed in Finding 1 of this report.

Exhibit A – Consolidated Financial Statements

USDA
RURAL DEVELOPMENT

FISCAL YEARS 2006 and 2005

(PREPARED BY RURAL DEVELOPMENT)

USDA Rural Development

Committed to the future of rural communities.

Consolidated Financial Statements

Fiscal Year 2006 and 2005

Prepared by: The Deputy Chief Financial Officer
St. Louis, Missouri

Rural Development

Management Discussion and Analysis

As of September 30, 2006

Rural Development's vision for rural America

Mission Statement

This Management Discussion and Analysis (MD & A), 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).

Rural Development's vision is for a rural America that is a healthy, safe, and a prosperous place to live, work, and grow. Its mission is to be committed to the future of rural communities. Rural Development is partnered with the rural residents to help increase economic opportunity and improve the quality of life.

As a venture capital entity, Rural Development invests in rural America to provide equity and technical assistance to finance and foster growth in homeownership, business developments, and critical community and technology infrastructures. Rural Development serves as a catalyst to improve conditions in rural America by offering financial and technical assistance needed to improve the quality of life in rural America, increasing the flow of capital through leveraged partnerships, and to 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 environment; electric power; and telecommunications, including distance learning and telemedicine.

USDA Rural Development has developed strategic goals that promote the implementation of its mission and vision, and a set of management strategies to ensure that these goals are implemented effectively. Targeted marketing tactics, sound management practices, innovation in the use of resources, and reliance on enhanced technology are integral to achieving these goals. These goals are consistent with Rural Development's efforts to support the President's Management Agenda (PMA). The PMA goals include the strategic management of human capital, improved financial performance, expanded eGovernment, competitive sourcing, support for faith-based organizations, and budget and performance integration.

Key Goals

Two key Rural Development goals are:

Goal 1. Increase Economic Opportunity in Rural America. Rural Development will increase economic development in rural America by strengthening rural technology infrastructures, providing communities with access to broadband service that allows participation in the developing global economy, providing access to capital and credit for development, encouraging growth and establishment of rural businesses, and promoting energy independence.

Goal 2. Improve the Quality of Life in Rural America. Rural Development will improve the quality of life in rural America by enhancing the ability of rural communities to develop, to grow, to share in a healthy economy, to realize an enhanced quality of life, and to improve their standard of living by targeting financial and technical resources to areas of greatest need through activities of greatest efficacy.

Organizational Structure

Rural Development's mission area is comprised of Rural Housing, Rural Utilities, and Rural Business-Cooperative programs.

Loan Programs

Rural Development loan programs, with an outstanding portfolio of approximately $94.6 billion, are delivered through a National Office, 47 state offices, and a network of field offices. The mission area is supported by the Office of the Deputy Chief Financial Officer in St. Louis, Missouri, which provides accounting and service support for all mission area programs, and a Centralized Servicing Center, also in St. Louis, which services the Direct Single Family Housing (SFH) portfolio. The mission area serves 319,617 SFH borrowers; 15,192 multi-family housing (MFH) borrowers; 11,491 business and community borrowers; and 1,919 tele-communications, electric, cable TV, broadband and distance learning and telemedicine borrowers.

In addition, through a network of approximately 3,100 lenders, Rural Development guarantees loans for approximately 192,391 SFH; 116 MFH; 3,143 business & community service; and 22 electric & cable TV borrowers.

Rural Development loan programs generally require (1) providing loans to individuals and enterprises that 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. Rural Development has the responsibility to protect the interest of the Government by adequately securing the loans with real estate mortgages, assignments of income, personal and corporate guarantees, and liens on revenues.

The portfolio that follows reflects a total loan portfolio balance higher in fiscal year (FY) 2006 than in FY 2005. There was an increase in the direct portfolio from $70.1 billion to $74.4 billion and the guaranteed portfolio from $19.5 billion to $20.2 billion.

Total Loan Portfolio as of September 30, 2006 FY's 2004 Through 2006 (Dollars in Billions)			
	FY 04	FY 05	FY 06
Direct Loans			
Single Family Housing	$13.6	$13.2	$13.0
Multi-Family Housing	11.8	11.8	11.6
Community Facilities/Other	1.4	1.9	2.2
Water & Environmental/Other	8.1	8.3	8.7
Electric	28.0	30.1	34.2
Telecommunications	3.6	3.4	3.9
Rural Telephone Bank	0.8	0.6	*
Business Programs	0.8	0.8	0.8
Total Direct	68.1	70.1	74.4
Guaranteed Loans			
Single/Multi-Family Housing	13.9	14.3	15.3
Community Facilities/Other	0.4	0.5	0.5
Water & Environmental/Other	0.1	0.1	0.1
Electric	0.5	0.4	0.4
Business Programs	4.1	4.2	3.9
Total Guaranteed	19.0	19.5	20.2
Total Loan Portfolio	**$87.1**	**$89.6**	**$94.6**

*****Rural Telephone Bank total loans are included in the Telecommunications totals for FY 2006.

Rural Development Programs

Business & Cooperative Programs

The purpose of the Business & Cooperative Program (BCP) is to enhance the quality of life for all rural Americans by providing leadership in building energy efficient and competitive businesses and sustainable cooperatives that can prosper in the global marketplace. Rural Development works in partnership with the private sector and community-based organizations to provide financial assistance and business planning. As a venture capital entity, Rural Development helps fund projects that create or preserve quality jobs and promotes clean rural environments.

These financial resources are often leveraged with those of other public and private credit source lenders to meet business and credit needs in under-served areas. Eligible recipients include individuals, Indian tribes, corporations, partnerships, cooperatives, and public bodies.

The Business and Industry (B&I) Guaranteed Loan program's primary purpose is to create and maintain employment and improve the economic climate in rural communities. This is achieved by expanding the lending capability of private lenders in rural areas, helping them make and service quality loans that provide lasting community employment benefits. The B&I program guarantees up to 80 percent of a loan made by a private lender. These loans can be used to fund business and industrial acquisition, construction, conversion, enlargement, repair or modernization. The maximum aggregate amount to any one borrower is $25 million, with certain cooperative ventures able to receive loans up to $40 million. The energy programs primary purpose is to stimulate investments in alternative and energy efficiency activity among farmers, ranchers, and small rural businesses. This population has small margins which are insufficient to capitalize new investments in long-term energy assets.

The program staff identifies the high risk loans and aggressively monitors slow pay and delinquent borrowers. To control an unacceptable growth in the delinquency rate of the guaranteed loan program, focus has been on intensifying training and oversight to protect the highest risk segments of the $4 billion portfolio.

Key Performance Indicator(s)

Business & Industry Guaranteed Loans and Grants	FY 2006 Target	FY 2006 Actual
Delinquency rate (excluding bankruptcy cases)	8%	6.13%
Small Businesses Assisted	8,804	12,716
Millions of kWh generated	1,764	7,298

Utilizing the Intermediary Relending Program (IRP), Rural Development provides concessionary loans (1 percent) to community based intermediaries to re-lend for business facilities and community development projects in rural areas, including cities with a population of less than 25,000 people. Private non-profit corporations, public agencies, Indian tribes, and cooperatives are eligible intermediaries. Interest and fee revenue received by the intermediary covers administrative costs and debt retirement. The funds are re-loaned to local small and start up businesses that are not yet eligible for traditional bank loans. The ultimate borrowers also receive business education and guidance and their business plan demonstrates an ability to start or expand local businesses, thereby creating employment or saving existing rural jobs.

The revolving loans funds financed under the IRP generate jobs in proportion to total loan funds. Jobs are computed for each $100,000 which on average is the amount that assists one ultimate recipient business. A study found that each business exists for 8.82 years. Therefore, total loan funds available to the intermediary revolve 3.4 times over the life of the loan. The total impact is 76.5 jobs generated per $100,000 in the current year budget authority.

The Rural Business Enterprise Grant program makes grants to public bodies, private non-profit corporations, and Federally-recognized Indian tribes to finance and facilitate the development of small and emerging business enterprises. Funds can be used to provide technical assistance such as marketing studies or training to small and emerging businesses. In addition, small and emerging businesses can use these funds to purchase machinery, establish initial capital for revolving funds, or construct facilities for business incubators.

The Rural Economic Development Loan and Grant programs provide grants and loans to Rural Development utility borrowers to promote sustainable rural economic development and job creation projects. Funds are used by electric or telephone utilities to relend, at zero percent interest, to eligible recipients. Funds can also be used to enhance or develop local amenities, so that rural communities can compete with metro areas for employers.

The purpose of the Rural Business Opportunity Grants is to promote sustainable economic development in rural communities with exceptional needs. This is accomplished by making grants to pay costs of providing economic planning for rural communities, technical assistance for rural businesses, or training for rural entrepreneurs or economic development officials.

Section 9006 Renewable Energy/Energy Efficiency Improvement Program has awarded grants and loans since 2003. The cumulative benefits include reduced need for importing millions of barrels of oil and reduced green house gas emissions. State Rural Development offices promote and screen applicants for both grants and loans.

The number of jobs to be created or saved is a critical element in determining the viability of a project for business funding, and as such, is a key performance indicator. The computed number of jobs created or saved is a one-time count credited to each loan when program funds are obligated. The number is based on credible information provided by the borrower and lender during the loan application process, based on a feasibility study or business plan, and is entered into the management database by Rural Development field staff. During the first year of the loan and subsequent compliance or servicing visits, Rural Development field staff update and verify the database. The number of jobs is only reported the year the loan is obligated.

During 2006, a sophisticated, state-of-the-art impact measurement system (Socio-Economic Benefit Assessment System, or SEBAS) was initiated by BCP. Following the collection of sufficient data, SEBAS will compute for every rural county, indirect hiring, local taxes collected and the change in Gross Domestic Product (GDP) for loan or grant funds obligated in each rural county and region and state. In addition, if subsequent annual operational data is collected on 2006 borrowers, SEBAS will compare projected changes (employment, local taxes, change in GDP) to actual changes for the same geographic areas each year. The continuous measurement system, SEBAS, has additional analytic capacity.

Key Performance Indicator(s)

Business & Cooperative Programs	FY 2006 Target	FY 2006 Actual
Total Number of Jobs Saved or Created	72,370	74,429

In 2006 the Cooperative Programs established performance measures for those programs which will be clearly identified to applicants for 2007 funding.

Community Development Program

Effective community development involves multiple partners working together on an effort that is long-term (often 10 years or more) and comprehensive (covering jobs, education, health care, water quality, and many other aspects of community life). Community leaders and citizens are the lead players in developing and implementing a local strategic plan. In many distressed rural communities (reflected in high poverty rates, high unemployment rates, and/or high outmigration rates), Rural Development is a critical partner in successful community development.

Rural Development often performs two functions in assuring that a distressed community can develop and implement a successful approach to community development. First, Rural Development provides funding for both the creation and the implementation of a community's strategic plan. For instance, over the past decade, 61 highly distressed communities have been provided multi-year grants through the Empowerment Zone-Enterprise Community program and through the Rural Economic Area Partnership (REAP) Zone program. Second, Rural Development staff provides technical assistance on key community development skills such as strategic planning, nonprofit board responsibilities, and fiscal management; this technical assistance is often vital for the success of a community's work. In addition, community development technical assistance has been provided to over 100 other distressed rural communities designated as Champion Communities.

For Rural Development to effectively serve its customers and provide the high quality technical assistance that will enable distressed communities to thrive, strong staff competence in community development skills is necessary. Thus, Rural Development staff training is an essential element of community development success.

Among the dozens of possible indicators of effective community development, only two are presented here. These indicators underline two key aspects of successful community development: 1) the creation and maintenance of a strong job base is a necessary ingredient for every community; and, 2) each community must reach far beyond Rural Development for the financial resources needed to implement its strategic plan and build a vibrant community.

Key Performance Indicator(s)

Community Development Program	FY 2006 Target	FY 2006 Actual
Number of jobs created and saved in Rounds I, II and III EZ/EC/CC & REAP communities	2,500	2,566
Rounds I, II & III EZ/EC/CC & REAP communities' leveraged dollars	350,000,000	311,031,883

The actual numbers presented here come from the Benchmark Management System (BMS). The BMS is used to track the progress that each community is making in achieving its various objectives, including the creation and saving of jobs and leveraging of dollars.

Housing & Community Facilities Programs

Housing & Community Facilities programs improve the quality of life in rural America by building competitive, vibrant rural communities.

Single Family Housing Programs

To promote homeownership, Rural Development provides financing, with no down payment and at favorable rates and terms, either through a direct loan or a loan from a private financial institution, which is guaranteed. The Direct SFH Program has the most loans in the housing portfolio. Direct SFH loans are made to families or individuals with very-low and low incomes to buy, build, improve, repair, and/or rehabilitate homes in rural areas. These loans are repayable over 33 years (with a maximum repayment of 38 years) at an effective interest rate as low as 1 percent annually. Low-interest loans and grants enable very-low income rural Americans to remove health and safety hazards in their homes and to make homes accessible for people with disabilities.

Rural Development also guarantees loans through partnerships with approximately 2,000 lenders. Loans may be guaranteed for an amount not to exceed 90 percent of the loan amount. Guaranteed loans are available for low and moderate-income families. These loans are repaid over 30 years with the interest rates negotiated between the customer and lender. The guaranteed loan program reflects the commitment to achieve maximum leveraging of the federal loan funds.

The following table reflects one of the key performance indicators for the SFH direct and guaranteed loan programs' objective of improving the quality of life for the residents of rural communities by providing access to decent, safe, affordable housing. The program provides the 100 percent loan-to-value financing needed to place qualified applicants in modest single family homes. Their quality of life is improved through the advantages of homeownership, which is the American Dream.

Key Performance Indicator(s)

Single Family Housing	FY 2006 Target	FY 2006 Actual
Number of rural households receiving financial assistance for housing.	43,530	42,953

USDA assisted 42,953 households with homeownership opportunities in FY 2006. This figure represents 98.6 percent of the target. This number is within 2 percent of the target and therefore the Agency believes that the goal has been substantially met. Of this number, approximately 11,865 of these opportunities were provided through the Section 502 Direct Loan program and the remainder through the Guaranteed program.

The targets were selected based on the Agency's expectations for loan obligations based on the anticipated price of housing and an expectation of a continuation of the low interest rate environment prevalent in 2004 and 2005.

While the Section 502 Guaranteed Loan program has obligated more funding than last year, the actual number of new homeowners is less than anticipated. The reason for this is that escalating home prices and rising interest rates have made housing less affordable for low and moderate-income borrowers. Higher home prices and higher interest rates make it more difficult for low and moderate-income borrowers to qualify for a loan. Those that do qualify need larger loans to purchase their homes, hence, more funding was obligated than last year despite a lower number of new homeowners.

The difficulties from higher interest rates and home prices shifted some of the demand to the Direct program because of the payment assistance feature and slightly longer loan terms, making the Direct program the only affordable option for many households. The Section 502 Direct program fully utilized its appropriated funds plus some additional funding obtained to assist with the recovery efforts from the 2005 Hurricane Disasters. As a result, the Direct program was able to provide more assistance than originally anticipated.

For Direct SFH loans, delinquency rate provides a good indicator of how well the accounts are monitored and supervised as well as "output" as it is a measure of those obtaining financing that are successful and are building homeownership equity.

Key Performance Indicator(s)

Single Family Housing	FY 2006 Target	FY 2006 Actual
Delinquency rate (Direct loans only)	Within 300 basis points of Federal Housing Administration (FHA) rate	June results are 150 basis points better than FHA. Averaged 134 basis points better than FHA for each quarter FHA reported (Q1-Q3) of 2006.
Delinquency Rate (Guaranteed loans)	Within 100 basis points of FHA Rate	June results are 253 basis points better than FHA

The June 30, FHA delinquency was 14.65 percent, with Single Family Housing Direct Loan (SFH-D) at 13.15 percent. This is 150 basis points better than FHA. This is the latest published FHA statistics. This statistic includes all delinquent loans including foreclosures in process for SFH-D and FHA. SFH-D year-end delinquency of 14.27 percent is 49 basis points better than prior year. The USDA Direct loan program significantly exceeded the target for FY 2006.

The Direct loan delinquency is adjusted for the impact of Hurricane Katrina and moratoriums granted as this is not a servicing option provided by FHA. All moratoriums were reviewed within 2006 and the fiscal year-end number is an un-adjusted number. June 30 is used as the benchmark because the FHA results are typically reported one fiscal quarter behind. (FHA September's figures will be released in January 2007.)

The June 30, 2006, FHA delinquency rate net of foreclosures was 12.30 percent, and the Single Family Housing Guaranteed (SFH-G) loan delinquency rate net of foreclosures was 9.77 percent. Thus, the SFH-G June 30, 2006, delinquency rate was 253 basis points better than the latest published FHA statistics. The SFH-G delinquency rate includes delinquency attributable to hurricanes Rita and Katrina. The SFH-G loan program significantly exceeded the target for FY 2006.

Multi-Family Housing Programs

The MFH program finances rural rental housing, farm labor housing, and cooperative housing for low income and elderly residents in rural communities of fewer than 10,000 population.

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 homes. In addition, grants are provided to public nonprofit organizations to assist rental property owners and co-ops to repair and rehabilitate their units.

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.

Guaranteed rental housing loans provide Federal Government guarantees for loans made by commercial lenders to developers of MFH for low- and moderate-income tenants in rural areas. USDA guarantees up to 90 percent of a loan made by a qualified lender. The program is designed to complement other affordable housing sources of financing, such as low-income housing tax credits.

To maintain an aging long-term quality portfolio, Rural Development has assessed the capital needs of its MFH portfolio to develop a long-term strategy for preserving projects in the portfolio for low-income residents. The result of these assessments established a section 515 multi-family portfolio revitalization program to provide for the 20-year deferral of repayments on existing debt, in exchange for project sponsors making necessary investments for the repair and rehabilitation of their projects. The cost of these repairs and rehabilitation cannot be included in rents.

Sustaining a low delinquency rate is an indicator to illustrate that the MFH loan portfolio is managed in a manner that is efficient and effective. Rural Development's goal to provide more quality housing to improve the lives of rural residents is achieved when delinquency and losses are minimized. By minimizing losses, the availability of affordable housing for eligible rural residents is maintained.

Key Performance Indicator(s)

Multi-Family Housing	FY 2006 Target	FY 2006 Actual
Number of projects with accounts more than 180 days past due (Direct loans only)	160	169

The MFH portfolio continued to perform well in FY 2006. The number of projects with accounts more than 180 days past due was at 169, which was slightly above the target number of 160. However, the dollar amount delinquent was reduced from the previous year by about $1 million.

Rental Assistance provides project-based rental assistance payments to property owners to subsidize the tenants' rent at an affordable level. By providing rental assistance, resources are directed to those rural communities and customers with the greatest need.

Key Performance Indicator(s)

Multi-Family Housing	FY 2006 Target	FY 2006 Actual
Total number of units selected for funding for New Construction	4,250	3,861
Total number of units selected for funding for rehabilitation	8,676	13,430
Decrease in number of families in substandard housing in the MFH portfolio	2,431	2,605
Decrease in number of families in the MFH properties paying more than 30 percent of income in rent	72,000	70,928
Increase the amount of leveraged funds in Rural Rental Housing for both New Construction and rehabilitation	$428,941,000	$505,672,400

New Construction units dropped below the target due to a decrease in the allocation of funding of the Rural Rental Housing Loans from New Construction towards rehabilitating existing properties. The number of new construction units was also impacted by a lower amount of Guaranteed Rural Rental Housing Loan funds used for New Construction and a greater emphasis on using these guaranteed funds for rehabilitation of existing affordable housing.

The number of rehabilitation units selected for funding was higher than the target by more than 54 percent. This increase can be attributed to several factors; the MFH Preservation and Revitalization efforts, the use of the Guaranteed Rural Rental Housing program rehabbing existing affordable housing properties, and the increased amount of leverage used in these rehab deals, thereby allowing more units to be renovated per program dollar.

The number of families paying more than 30 percent of their income towards rent decreased substantially in FY 2006. The reduction in rent overburdened tenants from FY 2005 to FY 2006 was about 7 percent. This can be attributed to improved performance in managing rental assistance and targeting utilization of assistance to those properties where the need is greatest.

Community Facilities Programs

Community Facility (CF) programs offer both direct and guaranteed loans to public entities such as municipalities, counties, and special purpose districts, as well as, nonprofit corporations and Indian tribes. These loans improve the quality of life of rural residents by providing access to modern, essential community facilities such as hospitals and health care clinics; fire, rescue and public safety facilities; educational facilities; nursing homes and assisted living facilities; and child and adult day care facilities. Recipients must demonstrate that they are unable to obtain financing from commercial sources. The term of the loan will be the useful life of the facility financed, State statute, or 40 years, whichever is less.

Historically, the largest dollar volume and number of loans and grants have gone to finance health care and public safety projects. Approximately 80 percent of CF projects fall into these two categories. Therefore, the two types have been chosen as performance measures. The availability of these types of facilities is inarguably of vital importance in the current world climate. At the same time, these facilities are increasing in technological complexity and expense, putting them beyond the financial reach of many rural, isolated communities.

Key Performance Indicator(s)

Community Facilities	FY 2006 Target	FY 2006 Actual
Increase the percentage of the rural population with access to improved health care services by 5.5 percent by 2010	5.1%	3.68%
Increase the percentage of the rural population with access to improved safety to 3 percent by 2010	2.6%	3.52%

CF failed to meet the FY 2006 health care target. This is attributable to several factors. The sharp increase in the cost of building materials in the wake of Hurricanes Katrina and Rita is likely a major factor. In addition, critical access hospitals are increasingly complex and require extended predevelopment and design periods. Rural Development is aware of several such facilities which were expected to be ready for funding in the FY just ended, but were unable to complete the required preliminary work in time. These projects will likely be funded when appropriations are received in the new FY.

The relatively large percentage increase in fire, rescue, and public safety facilities may reflect similar factors. In other words, some communities may have chosen to purchase fire and rescue vehicles as a means of more indirectly improving health and safety without incurring excessive building costs until the construction market is more stable.

Utilities Programs

The Utilities programs improve the quality of life in rural America by providing capital for its electric, telecommunications (including distance learning and telemedicine), and water and environmental projects in a service-oriented, forward-looking and financially responsible manner. The Utilities 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 restructuring of the electric industry advances toward a more competitive environment, Rural Development is ensuring the continued availability of reliable, high-quality electric service at a reasonable cost to rural consumers. The Electric programs provide financing and technical assistance to upgrade, expand, and maintain the vast electric utility infrastructure in rural America.

The Electric programs make loans and loan guarantees to finance the construction of electric distribution, transmission and generation facilities, including system improvements and replacement required to furnish and improve electric service in rural areas. Rural Development makes loans to corporations, states, territories, subdivisions, and agencies such as municipalities, utility districts, and cooperative, nonprofit, limited-dividend, or mutual associations that provide retail electric service needs to rural areas or power supply needs of distribution borrowers in rural areas. The program staff services approximately 700 active electric borrowers in 46 states, plus active territories of Marshall Islands, Puerto Rico, and American Samoa.

The electric cooperatives in the United States (U.S.) include 865 Distribution and 65 Generation and Transmission cooperatives. Cooperatives serve 39 million people in 46 states, 16 million businesses, homes, schools, churches, farms, irrigation systems, and other establishments in 2,500 of 3,100 counties. Cooperatives serve approximately 12 percent of the nation's population covering 75 percent of the nation's landmass.

Due to the lack of densities, electric cooperatives generate less revenue per investment than other electric utilities. Electric cooperatives serve an average of 7 consumers per mile of line and collect annual revenue of approximately $12,000 per mile of line. Investor-owned utilities average 34 customers per mile of line and collect $59,000 per mile of line. Publicly owned utilities, or municipals, average 44 consumers and collect $72,000 per mile of line.

Rural Development's goal of improving the quality of life of rural residents by promoting and providing access to capital and credit for the development and delivery of modern affordable utility services is reflected in the following performance indicators.

Key Performance Indicator(s)

Electric Loans – Direct and Guaranteed Loans	FY 2006 Target	FY 2006 Actual
Number and percentage of electric program borrowers' consumers receiving new or upgraded electric service	1,600,000 4.5%	8,183,649 34.9%
Dollar amount of consumers receiving new or upgraded electric service	$3,887,000,000	5,389,764,356

The Electric programs exceeded its performance goal target for FY 2006 by 6,583,649 consumers. The 2006 underestimation was due to a change in the interpretation of consumers receiving new or upgraded electric service. The estimation for 2006 was made excluding an estimation of generation and transmission consumers receiving new or upgraded electric service. After making the estimation, the Electric programs re-evaluate its methods of calculation of consumers. A method was developed which enabled the generation and transmission consumers to be included in the calculation and avoid double counting consumers. The target goal of 1,600,000 would still have been met even if the Electric programs had not changed its calculation of consumers. This recalculation also greatly impacted the percentage. Previously the percentages were in the 4 percent range. The Electric program is in the process of re-evaluating the calculation of the percentage results and also the targets to be set in future years.

The Rural Development Electric programs offer the following financing assistance: Hardship Loans, Treasury Rate Loans, Municipal Rate Loans, and Loan Guarantees. The primary differences between the programs are the qualifying criteria and the interest rate for each type of financing.

Guaranteed loans are provided by Rural Development primarily through the Federal Financing Bank (FFB), National Rural Utilities Cooperative Finance Corporation, and the CoBank. The FFB is an agency within the U.S. Treasury providing funding in the form of loans for various government lending programs, including the Rural Development Utilities programs, Electric programs, and Guaranteed loan programs. FFB loans are guaranteed by Rural Development and are available to all electric borrowers, but primarily used for generation and transmission loans.

Telecommunications Program

In order to meet the goal of increasing economic opportunity in rural America, USDA annually finances access to a seamless, nation-wide telecommunications network. Without access to advanced telecommunications networks, rural America will suffer the consequences in the form of declining educational opportunities, inadequate health care, depressed economies, and high unemployment.

Since private capital for the deployment of broadband services in rural areas is not sufficient, incentives offered by Rural Development as a venture capital entity are vitally important. Providing rural residents and businesses with barrier-free access to the benefits of today's technology will bolster the economy and improve the quality of life for rural residents and, ultimately, increase not only economic opportunity in rural America, but to the Nation as a whole.

Over the past 3 years, nearly $3 billion in loans have been provided to 229 entities for the deployment of advanced, state-of-the-art telecommunications networks serving rural areas. The facilities financed with these loans must be capable of offering high-speed service to all subscribers that request it. The primary technologies used to deliver this service are "digital subscriber line" - or DSL - service and "fiber-to-the-home" - or FTTH – systems, although other technologies are also deployed.

The Telecommunications program contains three major components: 1) loans for infrastructure improvement and expansion; 2) loans and grants for distance learning and telemedicine initiatives in rural areas; and 3) loans and grants specifically targeted for the deployment of broadband service in small towns and communities. Utilizing advanced telecommunications services, combined; these programs provide USDA with a powerful tool in building strong rural economies and increasing educational and health care services in rural communities across the U.S.

Due to the dissolution of the Rural Telephone Bank, all direct loans will now be serviced by the Utilities program area and reported as Telecommunication loans for FY 2006 and forward.

Key Performance Indicator(s)

Telecommunication	FY 2006 Target	FY 2006 Actual
Number of borrowers' subscribers receiving new and/or improved service	193,646	137,456
Percentage increase of borrowers' subscribers receiving new and/or improved service	5.7%	4.1%
Leveraging of telecommunications financial assistance (private investment to Rural Development funding)	$3.85:1	$3.45:1

The Telecommunication program did not meet its performance goals for 2006. This was primarily due to the fact that there were fewer subscribers receiving new or improved service under the loans funded. Rural Development continues to fund the deployment of advanced telecommunications facilities in rural America. In some cases, the financing provided by Rural Development reduces the operating and capital costs of the borrower, and/or improves the telecommunications capabilities of the borrowers, without a direct increase in the number of subscribers. The percentage of borrowers' subscribers receiving new or improved service was below target, primarily due to the fact that some loans processed were refinancing loans; again, as with the first performance factor, the borrowers benefit from the Rural Development financing in various ways, even if there is no increase in the number of subscribers. Also, some of the borrowers in the program have sold access lines or been acquired during the course of the year, thus reducing the number of access lines being measured. The leveraging factor was also below the target, primarily due to the large number of refinancing loans.

The Distance Learning and Telemedicine Program

Distance Learning and Telemedicine (DLT) program is having an impact in rural America by assisting rural schools and learning centers in gaining access to improved educational resources, and by assisting rural hospitals and health care centers in gaining access to improved medical care. Building on advanced telecommunications infrastructure, telemedicine projects are providing new and improved health care services and benefits to rural residents, many in medically underserved areas by linking to urban medical centers for clinical interactive video consultation, distance training of rural health care providers, and access to medical expertise and library resources. Distance Learning projects provide funding for computers and internet hookups in schools and libraries and promote confidence in, and understanding of, the world-wide-web and its benefits to students and young entrepreneurs.

Key Performance Indictor(s)

Distance Learning and Telemedicine	FY 2006 Target	FY 2006 Actual
Number of schools receiving distance learning facilities	618	556
Number of healthcare providers receiving telemedicine facilities	300	665
Leveraging of telemedicine and distant learning financial assistance (private investment to Rural Development funding)	$1:$1	$1:$.78

The DLT program exceeded its target for number of healthcare providers receiving telemedicine facilities and did not meet its goal for number of schools receiving distance learning facilities. The actual total number of providers exceeded the target total number of providers. The leveraging number was not met.

Broadband Program

The Farm Security and Rural Investment Act of 2002 (2002 Farm Bill) established a new loan and loan guarantee program “Access to Broadband Telecommunications Services in Rural Areas.” This program is designed to provide funding for the cost of constructing, improving, and acquiring facilities and equipment for broadband service in rural communities of 20,000 inhabitants or less. Program funds are provided through a variety of direct and guaranteed loans.

The building and delivery of advanced telecommunications networks are having a profound effect on our Nation’s economy, its strength, and its growth. Broadband networks in small rural towns will facilitate economic growth and provide the backbone for the delivery of increased educational opportunities over state- of-the-art telecommunications networks. Just as our citizens in our cities and suburbs benefit from access to broadband services, so should our rural residents. In rural America, access to broadband plays a vital role in solving the problems created by time, distance, location, and lack of resources. Broadband is a tool that allows people, communities, and organizations to consider new and different ways to interact, manage their lives, and do business.

Key Performance Indicator(s)

Broadband	FY 2006 Target	FY 2006 Actual
Number of borrowers' subscribers receiving new or improved service	75,000	159,571
Percentage increase of borrowers' subscribers receiving new or improved service	6%	125%

The Broadband program exceeded both its performance goals for FY 2006. The nature of the broadband industry and the rigorous review process of the loans make it difficult to predict how many applications will be received and how many will be approved by Program management.

Water and Environmental Program

Water and Environmental Program (WEP) loans and grants are provided to rural communities for the development, replacement, or upgrading of water and environmental facilities. Direct loans are repayable up to 40 years. One of the objectives of the WEP program is to provide rural residents with modern and affordable water and waste disposal services. Another objective is to direct program resources to those rural communities with the greatest need. This includes rural communities that are poverty-stricken as a result of out-migration, natural disasters or economic stress due to Federal actions.

Key Performance Indicator(s)

Water and Environmental	FY 2006 Target	FY 2006 Actual
Customers served by new or improved water & waste disposal facilities	570,000	1,637,554

In FY 2006, WEP invested $1.5 billion in direct and guaranteed loans and grants to provide technical assistance and help rural communities develop 1,207 water and waste disposal facilities.

Rural Development anticipates serving 142,500 program borrowers' subscribers quarterly and 570,000 on an annual basis. Quarterly targets for this measure are based on historical activity and are adjusted according to the program level received each FY. Except for the first quarter when we received limited funding for projects before we received our full budget, we have exceeded our performance targets. We surpassed our goal for FY 2006 by serving 1,637,554 program borrowers' subscribers. Several factors have contributed:

- Rural Development implemented underwriting tools to improve our performance in determining those communities that could afford maximum debt capacity. The result was that the WEP programs reached more communities needing Federal assistance.

- Rural Development implemented a “use or lose” policy for funding, which spurred rapid obligation activity over the third and fourth quarters.
- The trend for many water and sewer systems, especially drinking water, is to develop more regional projects that would serve a larger subscriber base.
- An appropriation of $50,000,000 for Emergency Hurricane and Tropical Storms (HTS) grants was received by Rural Development. These funds are available for projects in communities affected by a hurricane or tropical storm in calendar year 2003 or 2004. In FY 2005 and FY 2006, Rural Development obligated $39 million and $11 million respectively, for projects in HTS areas, which increased the number of subscribers served.
- An appropriation of $45,000,000 for Emergency HTS grants was received by Rural Development. These funds are available for projects in communities affected by a hurricane or tropical storm in calendar year 2005. In FY 2006, Rural Development obligated $15 million for projects in HTS areas.

Future Opportunities and Challenges

Rural Development is impacted by changes occurring in society as a whole. The growing concern about security as a result of the events of September 11, 2001, has resulted in the development of plans for continuing business in emergency situations and strengthened protection of business data and our informational systems. It has also impacted some of our customers, such as the WEP project receiving Rural Development assistance, which must be safe from terrorist attacks, or the critical access hospital which must be prepared to care for victims of such an emergency. Public safety is a major priority for Rural Development, as rural communities upgrade police, fire and rescue facilities and equipment to meet the challenges of the changed reality. Rural Development is continually evaluating its business practices to ensure they are both efficient and effective. Some opportunities and challenges resulting from these changes are summarized in the following areas:

Technology

Rural Development continues to respond to the increasing demand for eGovernment services and capabilities by supporting the USDA eGrants and eDeployment initiatives. Rural Development has developed a USDA-wide interface solution that allows USDA to receive grant applications from the GRANTS.gov site in a fully automated seamless manner. As part of the eDeployment initiative Rural Development has deployed and is currently enhancing the first USDA enterprise-wide document management application. Rural Development also currently offers via the internet over 150 forms to the public. These forms can be completed online and electronically submitted to field service centers for processing.

Rural Development also continues to promote web-based business applications such as the capability to advertise and sell SFH properties via the internet. This capability has been extended to the Farm Service Agency (FSA) in the advertisement and sale of farm properties. Rural Development took the lead in developing and deploying a “Homes for Sale” portal with the Department of Housing and Urban Development and the Veteran’s Administration. Rural Development has also developed and deployed for the General Services Administration a portal to advertise other federal properties for sale.

The MFH project management tenant data can now be entered via the internet and rental properties are being advertised via the internet to the public. New MFH automated rental assistance forecasting tools have been designed, developed, and put into use and will continue to be enhanced as more historical data is gathered.

Rural Development intends to implement an initiative to provide a web-based automated guaranteed underwriting system (GUS), to guaranteed loan lenders to allow them to more efficiently review and approve loan applications for Rural Development SFH-G loans. Pilot testing of GUS began on August 1, 2006 with a limited number of lenders. Additional lenders were added on October 1, 2006, in preparation for full implementation in January 2007. Lenders participating in Rural Development guaranteed loan programs are now able to submit loan loss claims via the internet.

Within Rural Development, initiatives such as the Data Warehouse provide employees with faster and easier access to data that crosses all business lines. This initiative is underpinning all automation support efforts to create a single, authoritative source of data. The demand to geo-code tabular loan data continues to grow at a significant pace. Maps are now available to the public to display eligible areas for Rural Development programs. Rural Development recently developed and deployed reports and maps for the Department of Agriculture which reflect civil rights data.

Rural Development has updated tactical business plans for all major loan programs outlining how current business processes will be transformed in order to electronically deliver programs directly to the public. These business plans are being linked to the technical architecture through the USDA Enterprise Architecture.

USDA eAuthentication is a system utilized by USDA agencies to enable customers to register and obtain accounts that allow them to access USDA web applications and services via the internet. This includes submitting forms electronically, completing surveys online, and checking the status of USDA accounts. Rural Development is working closely with USDA to deploy the secure technical environment necessary to support the delivery of programs to the public. Rural Development is collaborating with the FSA and the National Resources Conservation Service to employ common software development tools and to share program modules to leverage Information Technology investments.
Rural Development has consolidated all system components into 13 major applications and general support systems. Efforts continue to resolve all vulnerabilities identified during this process. Rural Development is currently in a "green" status on its information systems security scorecard.

These initiatives will impact Rural Development's future policies and regulations, automated systems, and organizational structure.

Budget and Performance Integration

Budget and Performance Integration is one of the government-wide initiatives in the PMA. This initiative focuses on performance and the utilization of performance data in budget decisions. Rural Development is working to complete the Program Assessment Rating Tool assessments, develop meaningful performance measures for its programs, develop methodologies for accurately monitoring the performance of programs and relate that performance to the total cost of those programs.

High Speed Internet Access

The advent of electronic commerce offers a great opportunity to rural businesses to participate in the global market, especially for the small entrepreneur or cooperative whose business is operating in a niche market. Internet access can also offer rural residents improved education and health care opportunities. Rural Development, through its telecommunication programs, is an important provider of broadband service to rural America.

Changes in Agriculture

While farming continues to be an important component in the economy of many rural areas, the agriculture industry is changing. In order to increase farm income, many farmers and ranchers are looking at value-added opportunities. The alternative fuel industry is developing rapidly providing additional opportunities to farmers and ranchers to market their products as well as use by-products of their existing operation as an additional source of income. New authorities granted to Rural Development in the 2002 Farm Bill are targeted to assisting these changes in agriculture.

Multi-Family Housing

Recent court decisions have given numerous MFH borrowers the opportunity to pay off their debt to Rural Development and use the property for something other than housing low income families. As a result of this action, rural America may lose a number of rental housing projects dedicated to housing low income families and the tenants living in these properties, many of whom are receiving rental assistance through Rural Development, will lose their access to rent subsidies. Rural Development will strive to minimize the impact on the existing tenants, including providing vouchers to tenants in those projects that have left our program, and to retain as many of these projects for low-income housing purposes as possible.

Highlights of Rural Development's Financial Position

The accompanying financial statements include the combined financial information for housing & community facilities, utilities, and business & cooperative programs.

Limitations on Financial Statements

These consolidated financial statements have been prepared to report the financial position and results of operations of the entity, 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, 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.

Entity's Systems, Controls, and Legal Compliance

The purpose of the Federal Managers' Financial Integrity Act (FMFIA) is to promote the development of systematic and proactive measures to ensure management accountability for the effectiveness and efficiency of program operations.

Section 2

Section 2 of the law focuses on the assessment of the adequacy of management controls to manage the risk associated with a given program and to provide reasonable assurance that obligations/costs comply with applicable laws and regulations; that Federal assets are safeguarded against fraud, waste and mismanagement; and that transactions are properly recorded and accounted for.

A material weakness identifies an instance in which the management controls are not sufficient to provide the level of assurance required by Section 2 and requires major milestones for corrective action. Such a weakness may significantly impair the fulfillment of an agency component's mission; deprive the public of needed services; violate statutory or regulatory requirements, significantly weaken safeguards against waste, loss, unauthorized use or misappropriation of funds, property, or other assets; or result in a conflict of interest.

For FY 2006, Rural Development is reporting that our internal controls are compliant with Section 2 of the FMFIA Report.

Section 4

Section 4 of the law relates to the review of financial accounting systems to ensure conformance with certain principles, standards, and other Federal requirements. A financial system nonconformance is an instance in which the financial system does not conform to the requirements of Section 4. A nonconformance also requires major milestones for corrective action.

For FY 2006, Rural Development provides qualified assurance that internal control, and financial management systems meet the objectives of FMFIA, with the exception of one material weakness related to general computer systems security and application controls.

Rural Development has fulfilled the requirements for documenting and testing of internal controls as directed by OMB Circular No. A-123, Management Accountability and Control.

Improper Payments Information Act of 2002

The Improper Payments Information Act of 2002 requires that the head of each agency annually review all programs and activities the agency administers to identify those that may be susceptible to significant improper payments. For each program or activity identified, the agency is required to estimate the annual amount of improper payments and, if the estimate is over $10 million, report the estimate to Congress along with the actions the agency is taking to reduce those improper payments.

Rural Development responded that all of its applicable programs had been assessed and reported that the Rural Development mission area had only one program, Section 521 Rental Assistance, identified as potentially being susceptible to significant improper payments and meeting the requirements for a statistically valid estimate of improper payments.

Actual Improper Payments	2005		2006	
	Dollars	Rate	Dollars	Rate
Program Outlays	*$846.1M		$838.0M	
Total Improper Payments	$ 27.0M	3.19%	$ 22.4M	2.99%
Overpayments	$ 17.5M	2.07%	$ 16.2M	1.94%
Underpayments	$ 9.5M	1.12%	$ 8.8M	1.05%
Other Improper Payments	N/A	N/A	N/A	N/A

*Estimated

The future target rates for improvement are:

Future Targets for Improvement	2007	2008	2009
Improper Payment Rate	2.79%	2.59%	N/A

Rural Development implemented a corrective action plan. A statistical sampling plan for use in estimating the error percentage and amount of improper payments has been developed. The Rural Development plan is based on the universe of MFH properties that receive rental assistance, selecting a 2 percent sample of the properties for review.

The oversight of borrowers and management agents was improved through the implementation of the 7 Code of Federal Regulations 3560, the new MFH regulation, dated February 24, 2005. Because of the newness of the regulation, Rural Development has not yet seen results of the improved guidance.

In addition, Rural Development is in the process of seeking legislation to obtain access to a data base of “new hires” information maintained by Health and Human Services. Also, Rural Development is requesting that the legislation include allowing borrowers and their management agents access to the “new hires” information because they are responsible for collecting and verifying the tenant’s income documentation.

Rural Development is training field staff and restructuring the supervisory visit procedure to strengthen and provide more focus when reviewing tenant files.

Rural Development will seek repayment of all valid unauthorized assistance received by the borrower or tenant, plus the cost of collection, to the fullest extent of the law.

Information system and infrastructure improvements needed to detect or reduce improper payments are not anticipated.

DEPARTMENT OF AGRICULTURE
RURAL DEVELOPMENT
CONSOLIDATED BALANCE SHEET
AS OF SEPTEMBER 30, 2006 AND 2005
(In Millions)

	2006	2005
Assets (Note 2):		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	$ 8,502	$ 11,637
Accounts Receivable, Net (Note 5)	1	8
Total Intragovernmental	8,503	11,645
Cash and Other Monetary Assets (Note 4)	98	91
Accounts Receivable, Net (Note 5)	0	1
Loans Receivable and Related Foreclosed Property, Net (Note 6)	64,613	60,761
General Property, Plant and Equipment, Net (Note 7)	68	68
Other (Note 8)	37	36
Total Assets	**73,319**	**72,602**
Liabilities (Note 9):		
Intragovernmental:		
Accounts Payable	4	1
Debt (Note 10)	59,088	54,365
Resources Payable to Treasury (Note 1N)	6,692	8,551
Other (Note 12)	898	1,291
Total Intragovernmental	66,682	64,208
Accounts Payable	93	101
Loan Guarantee Liability (Note 6)	954	926
Debt Held by the Public (Note 10)	0	2
Stock Payable to RTB Borrowers (Note 11)	0	1,390
Federal Employee and Veteran Benefits (Note 9)	29	30
Other (Note 12)	164	195
Total Liabilities	**67,922**	**66,852**
Commitments and Contingencies (Note 13)		
Net Position:		
Unexpended Appropriations	5,172	5,207
Cumulative Results of Operations	225	543
Total Net Position	**5,397**	**5,750**
Total Liabilities and Net Position	**$ 73,319**	**$ 72,602**

The accompanying notes are an integral part of these statements.

DEPARTMENT OF AGRICULTURE
RURAL DEVELOPMENT
CONSOLIDATED STATEMENT OF NET COST
FOR THE YEARS ENDED SEPTEMBER 30, 2006 AND 2005
(In Millions)

	2006	2005
Program Costs (Note 14):		
Intragovernmental Gross Costs	$	$
Borrowing Interest Expense	2,853	3,024
Other	280	290
Total Intragovernmental Gross Costs	3,133	3,314
Less: Intragovernmental Earned Revenue (Note 15)	348	416
Intragovernmental Net Costs	**2,785**	**2,898**
Gross Costs with the Public:		
Grants	1,769	1,810
Loan Cost Subsidies	822	(403)
Other	1,119	323
Total Gross Costs with the Public	3,710	1,730
Less: Earned Revenues from the Public (Note 15)	3,632	3,920
Net Costs with the Public	**78**	**(2,190)**
Net Cost Of Operations	**$ 2,863**	**$ 708**

The accompanying notes are an integral part of these statements.

DEPARTMENT OF AGRICULTURE
RURAL DEVELOPMENT
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
FOR THE YEARS ENDED SEPTEMBER 30, 2006 AND 2005
(In Millions)

Cumulative Results of Operations	**2006**	**2005**
Beginning Balances:	$ 543	$ 419
Adjustments	0	0
Beginning Balances, as Adjusted	**543**	**419**
Budgetary Financing Sources:		
Appropriations Used	3,324	3,232
Transfers-In/Out Without Reimbursement	(887)	(2,529)
Other Financing Sources:		
Transfers In/Out Without Reimbursement	(2)	0
Imputed Financing	110	129
Total Financing Sources	**2,545**	**832**
Net Cost of Operations	(2,863)	(708)
Net Change	(318)	124
Total Cumulative Results of Operations	**$ 225**	**$ 543**

Unexpended Appropriations		
Beginning Balances:	$ 5,207	$ 5,506
Adjustments	0	0
Beginning Balances, as Adjusted	**5,207**	**5,506**
Budgetary Financing Sources:		
Appropriations Received	3,299	2,997
Appropriations Transferred In/Out	15	11
Other Adjustments	(25)	(75)
Appropriations Used	(3,324)	(3,232)
Total Budgetary Financing Sources	**(35)**	**(299)**
Total Unexpended Appropriations	**5,172**	**5,207**
Net Position	**$ 5,397**	**$ 5,750**

The accompanying notes are an integral part of these statements.

DEPARTMENT OF AGRICULTURE
RURAL DEVELOPMENT
COMBINED STATEMENT OF BUDGETARY RESOURCES
FOR THE YEARS ENDED SEPTEMBER 30, 2006 AND 2005
(In Millions)

	2006		2005	
	Budgetary	**Non-Budgetary Credit Program Financing Accts.**	**Budgetary**	**Non-Budgetary Credit Program Financing Accts.**
Budgetary Resources:				
Unobligated Balance brought forward, Oct. 1	$ 4.494	$ 1,984	$ 3,751	$ 1,815
Recoveries of Prior Year Unpaid Obligations	304	859	273	487
Budget Authority				
Appropriation	3,298	0	2,997	0
Borrowing Authority (Notes 17 & 18)	0	10,038	0	8,475
Spending Authority from Offsetting Collections:				
Earned				
Collected	3,410	5,208	4,738	5,272
Change in Receivables from Federal Sources	(27)	0	19	0
Change in Unfilled Customer Orders				
Without Advance from Federal Sources	2	10	0	5
Nonexpenditure Transfers, Net, Anticipated & Actual	37	0	1	0
Permanently Not Available	(3,750)	(4,248)	(2,816)	(2,808)
Total Budgetary Resources	**$ 7,768**	**$ 13,851**	**$ 8,963**	**$ 13,246**
Status of Budgetary Resources:				
Obligations Incurred: (Note 16)				
Direct	$ 5,427	$ 12,546	$ 3,949	$ 11,262
Reimbursable	523	0	520	0
Unobligated Balance:				
Apportioned	244	515	362	1,457
Unobligated Balance Not Available	1,574	790	4,132	527
Total Status of Budgetary Resources	**$ 7,768**	**$ 13,851**	**$ 8,963**	**$ 13,246**
Change in Obligated Balance:				
Obligated Balance, Net				
Unpaid Obligations Brought Forward, Oct. 1	6,119	18,496	6,604	17,547
Uncollected Customer Payments from Federal Sources, Brought Forward, Oct. 1	(97)	(624)	(78)	(618)
Total Unpaid Obligated Balance, Net	**6,022**	**17,872**	**6,526**	**16,929**
Obligations Incurred, Net	5,950	12,546	4,469	11,262
Gross Outlays	(6,041)	(11,012)	(4,681)	(9,827)
Recoveries of Prior Year Unpaid Obligations	(304)	(859)	(273)	(487)
Change in Uncollected Customer Payments from Federal Sources	25	(10)	(19)	(5)
Obligated Balance, Net, End of Period:				
Unpaid Obligations (Note 22)	5,725	19,171	6,119	18,496
Uncollected Customer Payments from Federal Sources	(73)	(634)	(97)	(624)
Total Unpaid Obligated Balance, Net, End of Period	**5,652**	**18,537**	**6,022**	**17,872**
Net Outlays				
Gross Outlays	6,041	11,012	4,681	9,827
Offsetting Collections	(3,410)	(5,208)	(4,738)	(5,272)
Distributed Offsetting Receipts	(688)	0	(538)	0
Total Net Outlays	**$ 1,943**	**$ 5,804**	**$ (595)**	**$ 4,555**

See required supplementary information at the end of these footnotes for a breakdown by major budget account.

The accompanying notes are an integral part of these statements.

DEPARTMENT OF AGRICULTURE
RURAL DEVELOPMENT
CONSOLIDATED STATEMENT OF FINANCING
FOR THE YEARS ENDED SEPTEMBER 30, 2006 AND 2005
(In Millions)

	2006	2005
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations Incurred	$ 18,496	$ 15,731
Less: Spending Authority from Offsetting Collections and Recoveries	9,766	10,794
Obligations Net Offsetting Collections and Recoveries	8,730	4,937
Less: Offsetting Receipts	688	538
Net Obligations	8,042	4,399
Other Resources		
Transfers In/Out Without Reimbursement	(2)	
Imputed Financing from Costs Absorbed by Others	110	129
Net Other Resources Used to Finance Activities	108	129
Total Resources Used to Finance Activities	**8,150**	**4,528**
Resources Used to Finance Items Not Part of the Net Cost of Operations:		
Change in Budgetary Resources Obligated for Goods, Services and Benefits Ordered But Not Yet Provided	(354)	(464)
Resources That Fund Expenses Recognized in Prior Periods	(545)	(391)
Budgetary Offsetting Collections and Receipts That Do Not Affect Net Cost of Operations		
Credit Program Collections Which Increase Liabilities for Loan Guarantees or Allowances for Subsidy	8,018	9,498
Other	682	538
Resources That Finance the Acquisition of Assets	(13,122)	(10,718)
Other Resources or Adjustments to Net Obligated Resources That Do Not Affect Net Cost of Operations	8	
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	**(5,313)**	**(1,537)**
Total Resources Used to Finance the Net Cost of Operations	**2,837**	**2,991**
Components of the Net Cost of Operations That Will Not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Periods:		
Increase in Annual Leave Liability	9	0
Upward/Downward Reestimates of Credit Subsidy Expense	455	(782)
Increase in exchange revenue receivable from the public	0	1
Other	0	(33)
Total Components of Net Cost of Operations That Will Require or Generate Resources in Future Periods (Note 23)	464	(814)
Components Not Requiring or Generating Resources:		
Depreciation and Amortization	8	6
Revaluation of Assets or Liabilities	0	1
Other	(446)	(1,476)
Total Components of Net Cost of Operations That Will Not Require or Generate Resources	(438)	(1,469)
Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period	**26**	**(2,283)**
Net Cost of Operations	**$ 2,863**	**$ 708**

The accompanying notes are an integral part of these statements.

RURAL DEVELOPMENT

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

AS OF SEPTEMBER 30, 2006 AND 2005

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 United States Department of Agriculture (USDA) Rural Development mission area. The financial statements have been prepared from the books and records in accordance with the Office of Management and Budget (OMB) *Circular A-136, Financial Reporting Requirements.*

The amounts in the fiscal year (FY) 2005 column of the financial statements have been reclassified due to evolving changes in the guidance. This reclassification will facilitate a meaningful comparison between FY 2006 and FY 2005. Footnotes have also been reclassified due to evolving changes in guidance or presentation preferences.

B. Reporting Entity

The Federal Crop Insurance Reform and Department of Agriculture Reorganization Act of 1994, Public Law No. 103-354, was signed into law and this law permitted the reorganization of the Department of Agriculture. This law reaffirmed Rural Development's statutory authority. The mission area provides funding for rural housing programs, rural utilities programs, and rural business programs within the USDA.

With the passage of the 2006 Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriation Act, Public Law No. 109-97, the legal restriction on redeeming Government-owned Class A stock was removed. As a result of this change, the process of liquidation and dissolution of the Rural Telephone Bank (RTB) began. During FY 2008, RTB will be dissolved in its entirety and will no longer be a reportable entity. RTB is reported as part of the rural utilities program and included in Rural Development's mission area financial statements; however, it still has independent audited financial statements. Additional information on the liquidation and dissolution of the RTB can be found in **Note 1Q** and **Note 11**.

C. Basis of Accounting

The accounting principles and standards applied in preparing the financial statements are in accordance with guidance from the Federal Accounting Standards Advisory Board (FASAB), the Director of OMB and Comptroller General, which constitute generally accepted accounting principles for the Federal Government and its component entities. Guidelines from the Federal Credit Reform Act of 1990 contained in the Omnibus Budget Reconciliation Act of 1990 are also applied.

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 except for those Credit Reform transactions impacting the Statements of Budgetary Resources and Financing.

During FY 2006, no new Statements of Federal Financial Accounting Standards (SFFAS) were implemented, as none were applicable or material.

D. Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

E. Revenue and Other Financing Sources

Revolving/Credit Funds:
Beginning in FY 1992, the Federal Credit Reform Act of 1990 contained in the Omnibus Budget Reconciliation Act of 1990, provided Credit Reform procedures which affected the financing of the revolving funds. Under Credit Reform, an appropriation is received in the year the loan is made in a sufficient amount 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 appropriations which provided for reimbursement of

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 the United States Treasury (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, 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 in the current reporting period. 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.

F. Fund Balance with Treasury

All receipts and disbursements are processed by 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, Rural Development began collecting escrow payments (i.e., insurance and taxes) from new single family housing borrowers. Existing borrowers, which are delinquent and require servicing actions, must also submit escrow payments. The escrow payments are deposited with the Trustee, U.S. Bank. The Trustee is required to invest and disburse these funds as stipulated in the Trust Agreement. As of September 30, 2006 and 2005, the balance in this account was $98 million and $91 million, respectively. This amount has been included in the Consolidated Balance Sheet on the Cash and Other Monetary Assets **(Note 2)** and Other Liabilities **(Note 12)** lines. It has also been included on the Cash and Total Cash and Other Monetary Assets lines **(Note 4).**

H. Lending Activities

Direct loans are made by appropriated authority. These loans represent actual cash disbursements to borrowers which require repayment.

Other lending activities include the guarantee of loans for single family housing, multi-family housing, and community programs. The term “guarantee” means “to guarantee the repayment of loans to eligible borrowers originated, held, and serviced by a private financial agency or other lender approved by the Secretary of Agriculture."

Some guaranteed loans may be sold in the secondary market by the lender to an institution referred to as a holder. If the holder does not receive payment, Rural Development may purchase the loan. These loans are reported as direct loans by Rural Development.

I. Loans Receivable and Related Foreclosed Property, Net

Loans are accounted for as receivables after funds have been disbursed. They are carried at their principal amount outstanding **(Note 6**), and accrue interest 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.

Present value and Credit Reform prescribed methodology is used to value the remaining interest and principal portfolio. **Note 6** provides additional information on the methods used for the direct and guaranteed loans.

J. Property, Plant and Equipment

The land, buildings, and equipment in the current operating environment are 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.

Costs of Internal Use Software are accounted for in accordance with SFFAS No. 10, Accounting for Internal Use Software. SFFAS No. 10 requires the capitalization of the cost of Internal Use Software whether it is commercial off-the-shelf, contractor-developed, or internally-developed which solely meets internal or operational needs.

Internal Use Software is classified as "general property, plant and equipment" as defined in SFFAS No. 6, Accounting for Property, Plant and Equipment. See **Note 7** for further information.

The threshold for personal property is $25,000 and internal use software is $100,000.

K. 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.

L. Borrowings/Interest Payable to Treasury

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

M. Pension and Other Employee Benefits

Pension and other retirement benefits (primarily health care benefits) expense is recognized at the time employees' services are rendered. The expense is equal to the actuarial present value of benefits attributed by the pension plan's benefit formula, less the amount contributed by the employees. An imputed cost is recognized for the difference between the expense and contributions made by and for employees.

N. Resources Payable to Treasury

Rural Development's resources payable to Treasury represent the pre-credit reform funds assets that are in excess of the funds liabilities. After liquidating all the liabilities of these pre-credit reform funds, the funds are then returned to Treasury.

O. 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 **(Note 13)**.

P. 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 Treasury when their period of availability expires.

Q. Intragovernmental Financial Activities

The Rural Development mission area is an integral part of the operations of the 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.

The USDA has provided mission areas with an allocation of departmental nonreimbursed appropriated costs to include in their financial statements. These costs 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 government's vested interest in the Rural Telephone Bank is commonly referred to as "Class A stock." On September 30, 2005, in accordance with Bank Board Resolution 2005-1, the tenth redemption of Class A stock, in the amount of $19.4 million occurred leaving a balance of $368.9 million outstanding. In the second quarter, FY 2006, the liquidating account loan portfolio was valued at $303,762,013 and the A stock balance was adjusted by this amount; thereby leaving an A stock value owed by the RTB in the liquidating account of $65,099,747. In the third quarter, FY 2006, Rural Development paid to the Government the outstanding Class A stock balance.

R. Other Considerations

<u>Hurricanes Katrina and Rita</u>
In August and September 2005, parts of Alabama, Florida, Louisiana, Mississippi, and Texas were devastated by Hurricanes Katrina and Rita. Residences and infrastructure in this region were destroyed, and the government identified large parts of this region as federally-declared disaster areas. At the time, Rural Development's FY 2005 financial statements were published, the complete financial impact on Rural Development was unknown. Since that time, H.R. 2863, Department of Defense Appropriations Act, was approved and authorized Rural Development to provide assistance to those impacted by the hurricanes. As a result, certain Rural Development programs have been modified. For further information on these modifications, see **Note 6**.

NOTE 2: NON-ENTITY ASSETS

Amounts are presented in millions.

	FY 2006		FY 2005
With the Public			
Cash and Other Monetary Assets	$ 98		$ 91
Total Non-Entity Assets	98		91
Total Entity Assets	73,221		72,511
Total Assets	**$ 73,319**		**$ 72,602**

See **Note 1G** for a description of Cash and Other Monetary Assets. Non-Entity Assets represent assets that are **"not for use"** by Rural Development.

NOTE 3: FUND BALANCE WITH TREASURY

Amounts are presented in millions

	FY 2006		FY 2005
Fund Balances:			
Revolving Funds	$ 2,728		$ 5,705
Appropriated Funds	5,778		5,939
Other Fund Types	(4)		(7)
Total	**$ 8,502**		**$ 11,637**
Status of Fund Balance with Treasury: (FBWT)			
Unobligated Balance:			
Available	$ 1,410		$ 1,259
Unavailable	1,305		3,918
Obligated Balance Not Yet Disbursed	5,786		6,464
Non-Budgetary FBWT	1		(4)
Total	**$ 8,502**		**$ 11,637**

Fund balance with Treasury represents the undisbursed account balances with Treasury as reported in the mission area's records.

Included in the Unavailable line are restricted funds which are limited in their future use and are not apportioned for current use. These amounts represent the expired authority in fixed year Grant and Program accounts (fixed years prior to FY 2006) and are only available for restoration of funds. After the fifth year of expiration, all funds are returned to Treasury as required except those entities having extended authority. For FY's 2006 and 2005, there were approximately $53 million and $63 million in expired funds, respectively.

NOTE 4: CASH AND OTHER MONETARY ASSETS

Amounts are presented in millions.

	FY 2006		FY 2005
Cash	$ 98		$ 91
Total Cash and Other Monetary Assets	**$ 98**		**$ 91**

See **Note 1G** for a description of this Cash. As discussed in **Note 2**, this Cash is unavailable for Agency use.

NOTE 5: ACCOUNTS RECEIVABLE (A/R), NET

Amounts are presented in millions.

	FY 2006				
	Accounts Receivable, Gross		**Allowance for Uncollectible Accounts**		**Accounts Receivable, Net**
Intragovernmental					
A/R Revenue, Refund, Reimbursements	$ 1		$ 0		$ 1
Total Intragovernmental Accounts Receivable	**1**		**0**		**1**
With the Public					
Audit Receivable	0		0		0
Total Accounts Receivable	**$ 1**		**$ 0**		**$ 1**

	FY 2005				
	Accounts Receivable, Gross		**Allowance for Uncollectible Accounts**		**Accounts Receivable, Net**
Intragovernmental					
A/R Revenue, Refund, Reimbursements	$ 8		$ 0		$ 8
Total Intragovernmental Accounts Receivable	**8**		**0**		**8**
With the Public					
Audit Receivable	1		0		1
Total Accounts Receivable	**$ 9**		**$ 0**		**$ 9**

As of September 30, 2006 and 2005, the establishment of an allowance for uncollectible amounts was deemed unnecessary.

NOTE 6: LOANS RECEIVABLE AND RELATED FORECLOSED PROPERTY, NET

Balance Sheet Review

Direct loan obligations or loan guarantee commitments made post-1991, and the resulting direct loan or loan guarantees, are governed by the Federal Credit Reform Act of 1990 as amended. The Act requires agencies to estimate the cost of direct loans and loan guarantees at present value for the budget. Additionally, 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 are recognized as a cost in the year the loan or loan guarantee is disbursed. The net present value of loans or defaulted guaranteed loans receivable at any point in time is the amount of the gross loans or defaulted guaranteed loans receivable less the present value of the subsidy at that time.

The net present value of loans receivable is not necessarily representative of the proceeds that might be expected if these loans were sold on the open market.

Direct Loans

Loans receivable and related foreclosed property, net balances at the end of FY 2006 were $65 billion compared to $61 billion at the end of FY 2005. Defaulted guaranteed programs were $161 million and $192 million at the end of FY's 2006 and 2005, respectively. Table 1 below illustrates the overall composition of the Rural Development loan portfolio by mission area and loan program for FY 2006 and FY 2005. Direct loan obligations or loan guarantee commitments made pre-1992 and the resulting direct loans or loan guarantees are reported at net present value. The provision calculation is based upon the weighted-averaged subsidy rate of the financing account cohorts which have been substantially disbursed. In the case of most loan programs, substantially disbursed is 90 percent.

During the fiscal year, the gross outstanding balance of the direct loans obligated post-1991 is adjusted by the value of the subsidy cost allowance held against those loans. Current year subsidy expense, modifications, and reestimates all contribute to the change of the subsidy cost allowance throughout the year. The subsidy cost allowance moved from $2.6 billion to $3.2 billion during FY 2006, an increase of $.6 billion. During FY 2005, the allowance decreased $1.2 billion. Table 2 shows the reconciliation of subsidy cost allowance balances from FY 2005 to FY 2006.

The fluctuations in the housing financing subsidy cost allowance for FY 2006 and FY 2005 were due to model and data assumption changes. For FY 2006, the defaulted guaranteed loan programs, the business and industry program percentage of subsidy cost allowance compared to the outstanding portfolio decreased to reflect future potential defaults. For FY 2005, this comparison decreased due to the repurchase of additional guaranteed loans and the allowance not updated to reflect future potential defaults.

As of October 1, 2005, Rural Telephone Bank loans obligated pre-1992 have been transferred and reported under the Liquidating Electric and Telephone direct loan portfolio Treasury symbol as part of the Rural Telephone Bank dissolution. These loans will now be serviced under the Rural Utilities Telecommunication Program, in addition to the financing loans obligated post-1991. For FY 2005 reporting, the Rural Telephone Bank direct loan portfolios were reported as a separate line item. Due to the dissolution of the Rural Telephone Bank, the direct loan portfolios will be reported as telecommunication loans for FY 2006 and forward.

Total direct loan subsidy expense for FY 2006 is a combination of subsidy expense for new direct loans disbursed in the current year, modifications to existing loans, and interest rate and technical reestimates to existing loans. Total direct loan subsidy expense in FY 2006 was $690 million compared to $(584) million in FY 2005, an increase of $1.3 billion. This increase is largely due to the single family housing program. The credit reform subsidy model and data assumptions were changed in FY 2006 resulting in a reduced downward reestimate and thereby increasing subsidy expense. Table 3 illustrates the breakdown of total subsidy expense for FY's 2006 and 2005 by program.

Direct loan volume increased from $6.8 billion in FY 2005 to $7.8 billion in FY 2006. Volume distribution between programs is shown in Table 4. The electric loan disbursements accounted for the large increase in FY 2006.

Table 1

Total Credit Program Receivables and Related Foreclosed Property *(in millions)*					
FY 2006	**Loans Receivable, Gross**	**Interest Receivable**	**Foreclosed Property**	**Present Value Allowance**	**Value of Assets**
Direct Loans					
Obligated Pre-1992					
Housing Loans	$ 11,468	$ 99	$ 16	$ (5,196)	$ 6,387
Electric Loans	11,969	25	0	(1,460)	10,534
Telecommunications Loans	1,235	3	0	(79)	1,159
Rural Telephone Bank	0	0	0	0	0
Rural Development *	1,767	18	0	(232)	1.553
Development Loan Funds	45	0	0	(22)	23
Other Programs	3	0	0	0	3
Pre-1992 Total	**26,487**	**145**	**16**	**(6,989)**	**19,659**
Obligated Post-1991					
Housing Loans	13,163	62	16	(2,037)	11,204
Community Facility Loans	1,982	24	0	(63)	1,943
Electric Loans	22,236	4	0	(240)	22,000
Telecommunications Loans	2,718	5	0	77	2,800
Rural Telephone Bank	0	0	0	0	0
Water and Environmental Loans	7,104	73	0	(663)	6,514
Development Loan Funds	399	2	0	(154)	247
Business & Industry Funds	70	0	0	(66)	4
Economic Development	89	0	0	(8)	81
Post-1991 Total	**47,761**	**170**	**16**	**(3,154)**	**44,793**
Total Direct Loan Receivables	**74,248**	**315**	**32**	**(10,143)**	**64,452**
Defaulted Guaranteed Loans					
Pre-1992					
Rural Development Insurance Fund	4	0	0	0	4
Post-1991					
Community Facilities	3	0	0	0	3
Business and Industry	162	2	0	(10)	154
Housing Loans	13	0	0	(13)	0
Total Defaulted Guaranteed Loans	**$ 182**	**$ 2**	**$ 0**	**$ (23)**	**$ 161**
Total Loans Receivable and Related Foreclosed Property, Net					**$64,613**

* Prior to Credit Reform, Water and Environmental, Business and Industry and Community Facilities were combined under one Treasury Symbol and fund.

Total Credit Program Receivables and Related Foreclosed Property *(in millions)*					
FY 2005	**Loans Receivable, Gross**	**Interest Receivable**	**Foreclosed Property**	**Present Value Allowance**	**Value of Assets**
Direct Loans					
Obligated Pre-1992					
Housing Loans	$ 12,379	$ 114	$ 13	$ (5,112)	$ 7,394
Electric Loans	12,308	26	0	(1,599)	10,735
Telecommunications Loans	1,248	3	0	(117)	1,134
Rural Telephone Bank	274	1	0	8	283
Rural Development *	1,702	17	0	(249)	1,470
Development Loan Funds	52	0	0	(25)	27
Other Programs	3	0	0	0	3
Pre-1992 Total	**27,966**	**161**	**13**	**(7,094)**	**21,046**
Obligated Post-1991					
Housing Loans	12,761	55	18	(1,040)	11,794
Community Facility Loans	1,662	18	1	(74)	1,607
Electric Loans	17,857	2	0	(599)	17,260
Telecommunications Loans	2,177	3	0	13	2,193
Rural Telephone Bank	356	0	0	11	367
Water and Environmental Loans	6,639	64	0	(705)	5,998
Development Loan Funds	379	2	0	(151)	230
Business & Industry Funds	83	0	0	(76)	7
Economic Development	73	0	0	(6)	67
Post-1991 Total	**41,987**	**144**	**19**	**(2,627)**	**39,523**
Total Direct Loan Receivables	**69,953**	**305**	**32**	**(9,721)**	**60,569**
Defaulted Guaranteed Loans					
Pre-1992					
Rural Development Insurance Fund	3	0	0	0	3
Post-1991					
Community Facilities	9	0	0	0	9
Business and Industry	168	1	0	7	176
Housing Loans	4	0	0	0	4
Total Defaulted Guaranteed Loans	**$ 184**	**$ 1**	**$ 0**	**$ 7**	**$ 192**
Total Loans Receivable and Related Foreclosed Property, Net					**$60,761**

* Prior to Credit Reform, Water and Environmental, Business and Industry and Community Facilities were combined under one Treasury Symbol and fund.

Table 2

Schedule for Reconciling Subsidy Cost Allowance Balances (Post-1991 Direct Loans) *(in millions)*			
Beginning Balance, Changes, and Ending Balance	**FY 2006**		**FY 2005**
Beginning Balance of the subsidy cost allowance	$ 2,620		$ 3,826
Add: Subsidy expense for direct loans disbursed during the year by component			
Interest rate differential costs	(149)		(106)
Default costs (net of recoveries)	43		39
Fees and other collections	(3)		(7)
Other subsidy costs	342		343
Total of the above subsidy expense components	233		269
Adjustments			
Loan modifications	1		
Fees received	21		20
Loans written off	(86)		(70)
Subsidy allowance amortization	(89)		(530)
Other	21		(42)
Ending balance of the subsidy cost allowance before reestimates	2,721		3,473
Add or subtract subsidy reestimates by component			
Interest rate reestimates	92		116
Technical/default reestimate	364		(969)
Total of the above reestimate components	456		(853)
Ending balance of the subsidy cost allowance	**$ 3,177**		**$ 2,620**

Table 3

Direct Loan Subsidy by Program and Component *(in millions)*										
FY 2006	**Subsidy Expense for New Direct Loans Disbursed**						**Reestimates**			
	Interest Differ-ential	**Defaults**	**Fees and Other Colls**	**Other**	**Total**	**Total Modifi-cations**	**Interest Rate**	**Technical**	**Total**	**GRAND TOTAL**
Direct Loan Programs										
Housing Loans	$ (192)	$ 30	$ (3)	$ 362	$ 197	$ 0	$ 346	$ 456	$ 802	**$ 999**
Community Facility Loans	13	1	0	(2)	12	0	(9)	5	(4)	**8**
Electric Loans	(45)	9	0	(14)	(50)	1	(214)	(39)	(253)	**(302)**
Telecommunications Loans	0	2	0	(1)	1	0	(6)	(43)	(49)	**(48)**
Rural Telephone Bank	0	0	0	0	0	0	0	0	0	**0**
Water and Environmental Loans	53	1	0	(3)	51	0	(29)	(4)	(33)	**18**
Development Loan Funds	16	0	0	0	16	0	0	(2)	(2)	**14**
Business & Industry Funds	0	0	0	0	0	0	4	(9)	(5)	**(5)**
Economic Development	6	0	0	0	6	0	0	0	0	**6**
Total Subsidy Expense, Direct Loans	**$ (149)**	**$ 43**	**$ (3)**	**$ 342**	**$ 233**	**$ 1**	**$ 92**	**$ 364**	**$ 456**	**$ 690**

Direct Loan Subsidy by Program and Component ***(in millions)***										
FY 2005	**Subsidy Expense for New Direct Loans Disbursed**					**Modifications and Reestimates**				
	Interest Differ-ential	**Defaults**	**Fees and Other Colls**	**Other**	**Total**	**Total Modifi-cations**	**Interest Rate**	**Technical**	**Total**	**GRAND TOTAL**
Direct Loan Programs										
Housing Loans	$(189)	$ 34	$ (7)	$ 359	$ 197	$ 0	$ (43)	$ (700)	$(743)	**$ (546)**
Community Facility Loans	13	1	0	(1)	13	0	(8)	0	(8)	**5**
Electric Loans	(23)	2	0	(11)	(32)	0	126	(146)	(20)	**(52)**
Telecommunications Loans	(1)	1	0	(1)	(1)	0	26	(32)	(6)	**(7)**
Rural Telephone Bank	0	0	0	0	0	0	0	(6)	(6)	**(6)**
Water and Environmental Loans	77	1	0	(3)	75	0	16	(81)	(65)	**10**
Development Loan Funds	15	0	0	0	15	0	(1)	(2)	(3)	**12**
Business & Industry Funds	0	0	0	0	0	0	1	(2)	(1)	**(1)**
Economic Development	2	0	0	0	2	0	(1)	0	(1)	**1**
Total Subsidy Expense, Direct Loans	**$(106)**	**$ 39**	**$ (7)**	**$ 343**	**$ 269**	**$ 0**	**$ 116**	**$ (969)**	**$(853)**	**$ (584)**

Table 4

Total Amount of Direct Loans Disbursed (Post-1991) ***(in millions)***			
Direct Loans	**FY 2006**	**FY 2005**	**FY 2006 Over (Under) FY 2005**
Housing Loans	$ 1,385	$ 1,421	$ (36)
Community Facility Loans	405	323	82
Electric Loans	4,802	3,600	1,202
Telecommunications Loans	485	567	(82)
Water and Environmental Loans	675	855	(180)
Development Loan Funds	36	34	2
Business & Industry Loans	0	2	(2)
Economic Development	30	12	18
Total Direct Loans Disbursed	**$ 7,818**	**$ 6,814**	**$ 1,004**

Guaranteed Loans

Rural Development offers both direct and guaranteed loan products which are administered in coordination with conventional agricultural lenders for up to 90 percent of the principal loan amount. Guarantees for 100 percent of the principal loan are made for the electric programs. Under the guaranteed loan programs, the lender is responsible for servicing the borrower's account for the life of the loan. The Agency, however, is responsible for ensuring borrowers meet certain qualifying criteria to be eligible and monitoring the lender's servicing activities. Borrowers interested in guaranteed loans must apply to a conventional lender, which then arranges for the guarantee with the Agency. Guaranteed loans are reflected on the balance sheet in two ways: estimated losses on loan credit guarantees must be valued and carried as a liability and guaranteed loans purchased from third party holders are carried at net realizable value in loans receivable and related foreclosed property, net.

Guaranteed loans outstanding at the end of FY 2006 increased compared to the FY 2005 portfolio. At the end of FY 2006 and FY 2005, there were $20.2 billion and $19.5 billion in outstanding principal (face value) and $17.6 billion and $16.9 billion in outstanding principal (guaranteed), respectively. Table 5 shows the outstanding balances by loan program. The liability for loan guarantees and for guaranteed loans obligated prior to October1, 1991, are reported at present value which is the same methodology used by the direct loan programs. The provision calculation is based upon future cash flows discounted at the average interest rate of the 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.

During the fiscal year, the value of the guaranteed loans is adjusted by the value of the loan guarantee liability held against those loans. For the post-1991 guarantees, current year subsidy expense and reestimates all contribute to the change of the loan guarantee liability through the year. The loan guarantee liability is a combination of the liability for losses on pre-1992 guarantees and post-1991 guarantees. The total liability moved from $926 million to $954 million during FY 2006, an increase of $28 million. Table 6a shows the loan guarantee liability while table 6b shows the liability reconciliation for post-1991 guarantees.

Total guaranteed loan subsidy expense for FY 2006 is a combination of subsidy expense for new guaranteed loans disbursed in the current year and the interest rate and technical reestimates to existing loans. Total guaranteed loan subsidy expense in FY 2006 was $132 million compared to $181 million in FY 2005, a decrease of $49 million. This decrease was mainly due to the guaranteed housing program while community facility guaranteed programs experienced an increase. Table 7 illustrates the breakdown of total subsidy expense for FY 2006 and FY 2005 by loan program.

Guaranteed loan volume (face value) decreased from $3.8 billion in FY 2005 to $3.7 billion in FY 2006. The business and industry loans experienced the largest decrease. Volume distribution between programs is shown in Table 8.

Table 5

Loan Guarantees Outstanding (in millions)						
Guaranteed Loans	**Pre-1992 Outstanding Principal, Face Value**	**Post-1991 Outstanding Principal, Face Value**	**Total Outstanding Principal, Face Value**	**Pre-1992 Outstanding Principal, Guaranteed**	**Post-1991 Outstanding Principal, Guaranteed**	**Total Outstanding Principal, Guaranteed**
FY 2006						
Housing Loans	$ 7	$15,319	$15,326	$ 6	$13,787	$13,793
Community Facility Loans	5	570	575	4	499	503
Electric Loans	167	221	388	167	221	388
Business and Industry Loans	23	3,892	3,915	17	2,862	2,879
Water and Environmental	0	34	34	0	28	28
Other Programs	3	0	3	2	0	2
Total Guarantees Disbursed	**$ 205**	**$20,036**	**$20,241**	**$196**	**$17,397**	**$17,593**
FY 2005						
Housing Loans	$ 7	$14,293	$14,300	$ 6	$12,864	$12,870
Community Facility Loans	0	495	495	5	423	428
Electric Loans	233	221	454	233	221	454
Business and Industry Loans	35	4,191	4,226	22	3,098	3,120
Water and Environmental	0	32	32	0	26	26
Other Programs	3	0	3	3	0	3
Total Guarantees Disbursed	**$ 278**	**$19,232**	**$19,510**	**$269**	**$16,632**	**$16,901**

Table 6a

Liability for Loan Guarantees *(in millions)*						
	FY 2006			**FY 2005**		
	Liabilities for Losses on Pre-1992 Guarantees Present Value	**Liabilities for Loan Guarantees on Post-1991 Guarantees Present Value**	**Total Liabilities for Loan Guarantees**	**Liabilities for Losses on Pre-1992 Guarantees Present Value**	**Liabilities for Loan Guarantees on Post-1991 Guarantees Present Value**	**Total Liabilities for Loan Guarantees**
Liability for Loan Guarantees						
Housing Loans	$ 0	$ 592	$ 592	$ 0	$ 544	$ 544
Community Facility Loans	0	32	32	0	12	12
Electric Loans	0	0	0	0	1	1
Business and Industry Loans	2	328	330	2	367	369
Water and Environmental Loans	0	0	0	0	0	0
Other Programs	0	0	0	0	0	0
Total Liabilities for Loan Guarantees	**$ 2**	**$ 952**	**$ 954**	**$ 2**	**$ 924**	**$ 926**

Table 6b

Schedule for Reconciling Loan Guarantee Liability *(in millions)*			
Beginning Balance, Changes, and Ending Balance	**FY 2006**		**FY 2005**
Beginning Balance of the loan guarantee liability	**$ 924**		**$ 781**
Add: Subsidy expense for guaranteed loans disbursed during the year by component			
Interest supplement costs	10		6
Default costs (net of recoveries)	154		130
Fees and other collections	(92)		(73)
Other subsidy costs	0		0
Total of the above subsidy expense components	72		63
Adjustments:			
Loan guarantee modifications	0		
Fees received	67		70
Interest supplements paid	(1)		0
Claim payments to lenders	(110)		(143)
Interest accumulation on the liability balance	25		36
Other	(85)		(1)
Ending balance of the loan guarantee liability before reestimates	892		806
Add or subtract subsidy reestimates by component:			
Interest rate reestimate	33		22
Technical/default reestimate	27		96
Total of the above reestimate components	60		118
Ending balance of the loan guarantee liability	**$ 952**		**$ 924**

Table 7

Guaranteed Loan Subsidy Expense by Program and Component

(in millions)

FY 2006	**Subsidy Expense for New Guaranteed Loans Disbursed**					**Modifications and Reestimates**				
	Interest Supplement	**Defaults**	**Fees and Other Colls**	**Other**	**Total**	**Total Modifi-cations**	**Interest Rate**	**Technical**	**Total**	**GRAND TOTAL**
Guaranteed Loan Programs										
Housing Loans	$ 10	$ 96	$ (66)	$ 0	$ 40	$ 0	$ 16	$ 14	$ 30	**$ 70**
Community Facility Loans	0	1	(1)	0	0	0	4	17	21	**21**
Electric Loans	0	0	0	0	0	0	0	0	0	**0**
Business & Industry Funds	0	57	(25)	0	32	0	13	(4)	9	**41**
Total Subsidy Expense, Guaranteed Loans	**$ 10**	**$ 154**	**$ (92)**	$ 0	**$ 72**	**$ 0**	**$ 33**	**$ 27**	**$ 60**	**$ 132**

Guaranteed Loan Subsidy Expense by Program and Component *(in millions)*										
FY 2005	**Subsidy Expense for New Guaranteed Loans Disbursed**					**Modifications and Reestimates**				
	Interest Supplement	**Defaults**	**Fees and Other Colls**	**Other**	**Total**	**Total Modifi-cations**	**Interest Rate**	**Technical**	**Total**	**GRAND TOTAL**
Guaranteed Loan Programs										
Housing Loans	$ 6	$ 92	$ (63)	$ 0	$ 35	$ 0	$ 16	$ 69	$ 85	**$ 120**
Community Facility Loans	0	2	(2)	0	0	0	2	5	7	**7**
Electric Loans	0	0	0	0	0	0	0	0	0	**0**
Business & Industry Funds	0	36	(8)	0	28	0	4	22	26	**54**
Total Subsidy Expense, Guaranteed Loans	**$ 6**	**$ 130**	**$ (73)**	**$ 0**	**$ 63**	**$ 0**	**$ 22**	**$ 96**	**$118**	**$ 181**

Table 8

Guaranteed Loans Disbursed *(in millions)*				
	FY 2006		**FY 2005**	
	Principal, Face Value Disbursed	**Principal, Guaranteed Disbursed**	**Principal, Face Value Disbursed**	**Principal, Guaranteed Disbursed**
Guaranteed Loans				
Housing Loans	$ 3,056	$ 2,750	$ 3,036	$ 2,733
Community Facility Loans	131	114	93	80
Electric Loans	3	3	2	2
Business and Industry Loans	489	382	704	550
Water and Environmental Loans	1	1	5	4
Total Guaranteed Loans Disbursed	**$ 3,680**	**$ 3,250**	**$ 3,840**	**$ 3,369**

Credit Program Discussion and Descriptions

Each year, Rural Development programs create or preserve tens of thousands of rural jobs and provide or improve the quality of rural housing. To leverage the impact of its programs, Rural Development is working with state, local and Indian tribal governments, as well as private and nonprofit organizations and user-owned cooperatives.

Rural housing loan and grant programs provide affordable housing and essential community facilities to rural communities. Programs also help finance new or improved housing for moderate, low, and very low-income families each year. Rural housing programs also help rural communities to finance, construct, enlarge or improve fire stations, libraries, hospitals and medical clinics, industrial parks, and other community facilities.

The rural business program goal is to promote a dynamic business environment in rural America. These programs work in partnership with the private sector and community-based organizations to provide financial assistance and business planning. It also provides technical assistance to rural businesses and cooperatives, conducts research into rural economic issues, and provides cooperative educational materials to the public.

Rural utility programs help to improve the quality of life in rural America through a variety of loan programs for electric energy, telecommunications, and water and environmental projects. These programs leverage scarce Federal funds with private capital for investing in rural infrastructure, technology and development of human resources.

Rural Development is able to provide certain loan servicing options to borrowers whose accounts are distressed or delinquent. These options include reamortization, restructuring, loan deferral, lowering interest rate, acceptance of easements, and debt write-downs. The choice of servicing options depends on the loan program and the individual borrower.

Rural Development List of Programs

Rural Business-Cooperative Programs

Business and Industry Direct Loans
Business and Industry Guaranteed Loans
Intermediary Relending Program Direct Loans
Rural Economic Development Direct Loans

Rural Housing Programs

Community Facilities Direct Loans
Community Facilities Guaranteed Loans
Farm Labor Housing Direct Loans
Home Improvement and Repair Direct Loans
Home Ownership Direct Loans
Home Ownership and Home Improvement and Repair Nonprogram Loans
Home Ownership Guaranteed Loans
Multi-family Housing – Nonprogram - Credit Sales
Rental Housing Guaranteed Loans
Rural Rental and Rural Cooperative Housing Loans
Rural Housing Site Direct Loans

Rural Utilities Programs

Electric Direct Loans
Electric Guaranteed Loans
Rural Telephone Bank Direct Loans
Telecommunications Direct Loans
Water and Environmental Direct Loans
Water and Environmental Guaranteed Loans

Table 9a

Program Characteristics – Direct			
Major Programs (Direct)	**Repayment Period**	**Interest Rate**	**Unique Servicing Option**
Housing Single-Family	Maximum 30-38 years/program	Current	Payment assistance – payment moratoriums – loan reamortization
Rural Rental/Rural Cooperative	1997 and prior – 50 years Subsequent – 50 year amortization with 30 year repayment and balloon	Current	Payment assistance – rental assistance to tenants
Community Facility	Maximum 40 years	4.5% to current	Workout agreements – loan reamortization
Water and Environmental	Useful life not to exceed 40 years	< or equal 5% to current	Principal payment deferments – loan reamortization – loan transfers
Electric	Maximum 35 years	Current	Payment deferments – loan reamortization – discounted loan prepayments Loans prior to 11/93 received interest rates from 2-5%
Telecommunications	Expected composite life (depreciated life plus 3 years)	5-7%	Payment extension
Rural Telephone Bank	Expected useful life not to exceed 35 years	Current or 5%	Payment extension
Development Loans Intermediary Relending	Maximum 30 years	1%	Payment moratoriums
Business and Industry	Maximum 7-30 years per program	Current	Loan reamortization – loan transfer

Table 9b

Program Characteristics – Guaranteed			
Major Programs (Guaranteed)	**Repayment Period**	**Interest Rate**	**Unique Servicing Option**
Housing Single-Family	Maximum 30 years	Lender	Maximum 90% guarantee – Lender pays 2% fee – Loans may be sold to third party
Rental Housing	Maximum 40 years	Lender	.5% annual fee is also charged.
Community Facilities	Maximum 40 years	Lender	Maximum 90% guarantee – Lender pays 1% fee – Loans may be sold to third party
Electric	Maximum 35 years	Lender	100% Guarantee
Business and Industry	Maximum 7-30 years per program	Lender	Guarantee maximum 60-80% - Lender pays 2% fee and .25% annual fee.
Water and Environmental	Maximum 40 years	Lender	Rates will be negotiated between the lender and the borrower. They may be fixed or variable rates.

Discussion of Administrative Expenses, Subsidy Costs, and Subsidy Rates

Administrative Expenses

Consistent with the Federal Credit Reform Act of 1990 as amended, subsidy cash flows exclude direct Federal administrative expenses. Administrative expenses are shown in Table 10.

Table 10

Administrative Expenses (*in millions)*			
FY 2006			
Direct Loan Programs	**Amount**	**Guaranteed Loan Programs**	**Amount**
Total	**$ 229**	***Total***	**$ 248**
FY 2005			
Direct Loan Programs	**Amount**	**Guaranteed Loan Programs**	**Amount**
Total	**$ 220**	***Total***	**$ 248**

Reestimates, Default Analysis, and Subsidy Rates

The Federal Credit Reform Act of 1990 as amended, governs the proprietary and budgetary accounting treatment of direct and guaranteed loans. The long-term cost to the government for direct loans or loan guarantees is referred to as "subsidy cost". Under the Act, subsidy costs for loans obligated beginning in FY 1992 are recognized at the net present value of projected lifetime costs in the year the loan is disbursed. Subsidy costs are revalued annually. Components of subsidy include interest subsidies, defaults, fee offsets, and other cash flows.

Based on a sensitivity analysis conducted for each cohort or segment of a loan portfolio, the difference between the budgeted and actual interest for both borrower and Treasury remain the key components for the subsidy formulation and reestimate rates of many USDA direct programs. USDA uses the government-wide interest rate projections provided by the Office of Management and Budget in order to do its calculations and analysis.

Rural Development's cash flow models are tailored for specific programs based on unique program characteristics. The models utilized are housing, guaranteed, and a direct model that covers the remaining portfolio with similar characteristics. Actual budgetary reestimates lag a year behind while the approximator method is used for financial statement purposes. For example, the FY 2005 and FY 2004 actual budgetary reestimates were recorded as of September 30, 2006 and 2005, respectively. The three exceptions to the method are the single family housing, multi-family housing, and electric underwriter programs whose reestimates are recorded in the current fiscal year.

In FY 2006 and FY 2005, Rural Development guaranteed loan programs recorded prior year actual budgetary reestimates and current year activity estimates for material programs. A key sensitivity element in the guaranteed programs is defaults.

Analysis was performed on reestimates and subsidy rates for the direct and guaranteed programs. For FY 2006, the two direct programs, electric and housing, had net reestimates of $(253) and $802 million, respectively. The Federal Financing Bank electric loan cohort and Underwriters cohort had a downward reestimate due to actual differences between the Treasury discount rate and the borrower interest rate varying from the original assumptions. In conjuction, the borrower rate and payment consistency contributed to the Government cost savings and reduced subsidy expense. The housing reestimates expense for FY 2006 and 2005 were impacted by multiple reestimates as a result of model and data assumption changes. In FY 2005, the water and environmental programs experienced decreases in the single effective rate, which is driven by the Treasury yield curve and cash flows. In addition, the actual borrower payments exceeded scheduled payments. These events resulted in downward adjustments of $65 million for the actual and estimated amounts.

Table 7 shows that the guaranteed programs recorded a $60 million reestimate increase in the current period. For FY 2006 and FY 2005, the guaranteed program reestimate amounts were within normal range.

Subsidy rates are used to compute each year’s subsidy expenses as disclosed in Tables 3 and 7. The subsidy rates disclosed below pertain only to the FY 2006 cohorts. These rates cannot be applied to the direct and guaranteed loans disbursed during the current reporting year to yield the subsidy expense. The subsidy expense for loans reported in the current year could result from disbursements of loans from both current-year cohorts and prior-year cohorts. Table 11 has the direct loan subsidy rates for FY 2006 and FY 2005 and Table 12 has two guaranteed program subsidy rates. The existing program subsidy rates were consistent between fiscal years.

Modifications

A modification is any Government action different from the baseline assumptions that affects the subsidy cost, such as a change in the terms of the loan contract. The cost of a modification is the difference between the present value of the cash flows before and after the modification. In FY 2006, Rural Development modified several loan programs.

The multiple-family housing direct loan program was modified due to the revitalization project. The revitalization project is used to rehabilitate ailing housing developments. In this program, Rural Development determines whether the development owner should be offered a financial restructuring plan and what type of incentives, if any, should be offered to the owner to rehabilitate an ailing housing development and to provide affordable rents for tenants who live in such projects that are revitalized.

The electric program direct loans have been modified for two borrowers due to damage caused by the hurricanes which occurred during the 2005 calendar year. One borrower's loans were modified to defer principal payments for three years and to extend the loan term for three years. The other modification was made to defer principal and interest for five years and to extend the maturity by five years.

The guaranteed single-family housing loan programs were modified to enable eligible delinquent borrowers that were impacted by the hurricanes which occurred during the 2005 calendar year to receive a one-time advance from their loan servicer in an amount equal to not more than 12 months past due mortgage payments. Loan servicers are reimbursed by Rural Development and the borrower is required to repay Rural Development.

To determine the cost of the above modifications, the most recently approved President's budget was used for the net present value discount factor for the pre-modification cash flow, which was FY 2006. The post modification cash flows are discounted at the net present value discount factor for the FY 2004 Reestimates for the respective cohort.

Table 11

Subsidy Rates for Direct Loans (Percentage)											
FY 2006						**FY 2005**					
	Interest Differential	Defaults	Fees and Other Colls.	Other	Total		Interest Differential	Defaults	Fees and Other Colls.	Other	Total
Direct Loan Programs						**Direct Loan Programs**					
Section 502 Single-Family Housing	-16.77	2.32	0.00	25.84	11.39	Section 502 Single-Family Housing	-17.35	2.68	0.00	26.25	11.58
Section 504 Housing Repair	27.00	2.45	0.00	-0.20	29.25	Section 504 Housing Repair	26.95	2.38	0.00	-0.27	29.06
Credit Sales Section 203 (SFH)	-19.35	1.16	0.00	3.66	-14.53	Credit Sales Section 203 (SFH)	-21.08	1.72	0.00	3.13	-16.23
Section 514 Farm Labor Housing	44.91	0.03	0.00	-0.35	44.59	Section 514 Farm Labor Housing	45.87	0.02	0.00	1.17	47.06
Section 515 Rural Rental Housing	-17.86	0.04	-0.05	63.75	45.88	Section 515 Rural Rental Housing	-18.03	0.02	-0.05	65.15	47.09
Section 523 Self-Help Housing Land Development	1.03	0.00	0.00	0.00	1.03	Section 523 Self-Help Housing Land Development	-0.47	0.00	0.00	0.00	-0.47
Section 524 Housing Site Development	-4.30	0.79	0.00	0.00	-3.51	Section 524 Housing Site Development	-5.91	0.96	0.00	0.01	-4.94
Credit Sales Section 209 (MFH)	-19.82	0.12	0.00	65.10	45.40	Credit Sales Section 209 (MFH)	-18.85	0.07	0.00	67.22	48.44
Community Facilities	3.59	0.24	0.00	-0.48	3.35	Community Facilities	4.48	0.24	0.00	-0.67	4.05
Distance Learning and Telemedicine	0.00	1.63	0.00	-0.13	1.50	Distance Learning and Telemedicine	0.00	1.61	0.00	-0.19	1.42
Broadband	0.00	2.22	0.00	-0.07	2.15	Broadband	0.00	2.27	0.00	-0.14	2.13
Water & Waste Disposal	7.14	0.09	0.00	-0.32	6.91	Water & Waste Disposal	9.36	0.10	0.00	-0.46	9.00
Electric Hardship	0.69	0.02	0.00	0.21	0.92	Electric Hardship	3.19	0.03	0.00	-0.18	3.04
Electric Municipal	4.68	0.02	0.00	0.35	5.05	Electric Municipal	1.63	0.03	0.00	-0.31	1.35
FFB Electric	-0.49	0.02	0.00	-0.01	-0.48	FFB Electric	-1.35	0.01	0.00	-0.89	-2.23
Electric Treasury	0.00	0.02	0.00	-0.01	0.01	Electric Treasury	0.00	0.03	0.00	-0.08	-0.05
Telephone Hardship	-1.84	0.02	0.00	0.02	-1.80	Telephone Hardship	-1.25	0.02	0.00	0.02	-1.21
Telephone Treasury	0.00	0.03	0.00	0.02	0.05	Telephone Treasury	0.00	0.05	0.00	-0.01	0.04
FFB Telephone	-1.03	0.02	0.00	-0.56	-1.57	FFB Telephone	-1.03	0.12	0.00	-1.04	-1.95
Rural Telephone Bank	Not Funded					Rural Telephone Bank	-1.43	0.02	0.00	-0.42	-1.83
Intermediary Relending Program	43.84	0.00	0.00	-0.82	43.02	Intermediary Relending Program	46.64	0.00	0.00	-0.26	46.38
Rural Economic Development	21.40	0.07	0.00	-1.50	19.97	Rural Economic Development	20.32	0.04	0.00	-1.57	18.79
Business and Industry	Not Funded					Business and Industry	0.00	0.00	0.00	0.00	0.00
Broadband 4% Loan Program	5.83	2.13	0.00	-0.01	7.95	Broadband 4% Loan Program	5.83	2.18	0.00	0.00	8.01
Electric Underwriting	-2.09	0.83	0.00	0.00	-1.26	Electric Underwriting	0.00	0.00	0.00	0.00	0.00
MFH Preservation	46.76	0.00	0.00	0.00	46.76						

Table 12

Subsidy Rates for Loan Guarantees (Percentage)											
FY 2006						**FY 2005**					
	Interest Differential	Defaults	Fees and Other Colls.	Other	Total		Interest Differential	Defaults	Fees and Other Colls.	Other	Total
Guaranteed Loan Programs						**Guaranteed Loan Programs**					
Section 502 Single-Family Housing	0.00	3.16	-2.00	0.00	1.16	Section 502 Single-Family Housing	0.00	3.07	-2.00	0.00	1.07
Section 502 Single-Family Housing - Refinance	0.00	0.79	-0.50	0.00	0.29	Section 502 Single-Family Housing - Refinance	0.00	0.77	-0.50	0.00	0.27
Section 538 Multi-Family Housing	12.28	0.57	-7.44	0.01	5.42	Section 538 Multi-Family Housing	10.32	0.55	-7.39	0.01	3.49
Community Facilities	0.00	1.21	-0.85	0.00	0.36	Community Facilities	0.00	0.93	-0.84	0.00	0.09
Electric	0.00	0.09	0.00	0.00	0.09	Electric	0.00	0.06	0.00	0.00	0.06
Business and Industry	0.00	8.20	-3.41	0.00	4.79	Business and Industry	0.00	6.51	-1.47	-0.01	5.03
NAD Bank	0.00	13.76	-3.28	-0.01	10.47	NAD Bank	0.00	9.91	-1.61	0.00	8.30
Broadband Loans	0.00	3.82	0.00	0.00	3.82	Broadband Loans	0.00	3.93	0.00	0.00	3.93
Water and Waste	0.00	0.00	-0.90	0.00	-0.90	Water and Waste	0.00	0.00	-0.90	0.00	-0.90
Renewable Energy	0.00	8.20	-1.75	0.00	6.45	Renewable Energy	0.00	6.51	-0.78	0.00	5.73

Other Disclosures

Foreclosed Property

Property is acquired largely through foreclosure and voluntary conveyance. Acquired properties associated with 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).

For FY's 2006 and 2005, rural housing program properties consisted primarily of 530 and 587 rural single-family dwellings, respectively. The average holding period for single-family housing properties in inventory for FY's 2006 and 2005 was 27 months and 26 months, respectively. The approximate number of borrowers for which foreclosure proceedings were in process at the end of FY's 2006 and 2005 was 8,300 and 19,200, respectively. Certain properties can be leased to eligible individuals.

Commitments to Guarantee

As of September 30, 2006 and 2005, there were approximately $2.0 billion and $1.8 billion in commitments to extend loan guarantees, respectively.

Non-performing Loans

Rural Development's loan interest income on non-performing receivables is calculated but the recognition of revenue is deferred. Non-performing receivables are defined as receivables that are in arrears by 90 or more days.

Interest Credit

Approximately $17.9 billion and $18.2 billion of the rural housing programs unpaid loan principal as of September 30, 2006 and 2005, respectively, was receiving interest credit. If those loans receiving interest credit had interest accrued at the full-unreduced rate, interest income would have been approximately $1.0 billion and $1.1 billion higher for FY's 2006 and 2005, respectively. At the end of FY's 2006 and 2005, the Rural Development housing portfolio contained approximately 81 thousand and 80 thousand restructured loans with an outstanding unpaid principal balance of $2.6 billion and $2.6 billion, respectively.

NOTE 7: GENERAL PROPERTY, PLANT AND EQUIPMENT, NET

Amounts are presented in millions.

This equipment generally represents computer hardware, software, and other office equipment used in the Rural Development mission area's network of offices. Refer to **Note 1J** for further information.

FY 2006						
Classes	**Cost**	**Accumulated Depreciation**	**Book Value**	**Estimated Useful Life***	**Method of Depreciation****	**Capitalization Threshold**
Personal Property						
Equipment	$ 5	$ 4	$ 1	1-5	SL	$ 25,000
Internal Use Software	80	19	61	2-15	SL	$ 100,000
Internal Use Software in Development	6	0	6	2-15	SL	$ 100,000
Total	**$ 91**	**$ 23**	**$ 68**			

FY 2005						
Classes	**Cost**	**Accumulated Depreciation**	**Book Value**	**Estimated Useful Life***	**Method of Depreciation****	**Capitalization Threshold**
Personal Property						
Equipment	$ 11	$ 7	$ 4	1-5	SL	$ 25,000
Internal Use Software	66	12	54	2-15	SL	$ 100,000
Internal Use Software in Development	10	0	10	2-15	SL	$ 100,000
Total	**$ 87**	**$ 19**	**$ 68**			

* Range of Service Life

** SL – Straight Line

NOTE 8: OTHER ASSETS

Amounts are presented in millions.

	FY 2006		FY 2005
With the Public			
Investment in Loan Asset Sale Trust*	$ 35		$ 34
Other	2		2
Total Other Assets	**$ 37**		**$ 36**

* In FY 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 entitle 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 9: LIABILITIES NOT COVERED BY BUDGETARY RESOURCES

Amounts are presented in millions.

	FY 2006		FY 2005
Intragovernmental			
Unfunded Federal Employees Compensation Act (FECA) Liability	$ 6		$ 5
Total Intragovernmental	**6**		**5**
With the Public			
Federal Employee and Veteran Benefits	29		30
Unfunded Annual Leave	36		27
Total Liabilities Not Covered by Budgetary Resources	71		62
Total Liabilities Covered by Budgetary Resources	67,851		66,790
Total Liabilities	**67,922**		**66,852**

Liabilities not covered by budgetary resources represent liabilities for which Congressional action is required before budgetary resources can be provided.

NOTE 10: DEBT

Amounts are presented in millions.

	FY 2005 Beginning Balance	Net Borrowing	FY 2005 Ending Balance	Net Borrowing	FY 2006 Ending Balance
Intragovernmental Debt					
Debt to the Treasury	28,971	2,588	31,559	2,270	33,829
Debt to the Federal Financing Bank (FFB)	22,160	646	22,806	2,453	25,259
Total Intragovernmental Debt	**51,131**	**3,234**	**54,365**	**4,723**	**59,088**
Agency Debt					
Held by the Public	$ 2	$ 0	$ 2	(2)	0
Notes Payable	0	0	0	0	0
Total Agency Debt	**2**	**0**	**2**	**(2)**	**0**
Total Debt	**$ 51,133**	**$ 3,234**	**$ 54,367**	**4,721**	**59,088**

	FY 2006	FY 2005
Classification of Debt		
Intragovernmental Debt	$ 59,088	$ 54,365
Debt Held by the Public	0	2
Total Debt	**$ 59,088**	**$ 54,367**

Borrowing from the Federal Financing Bank (FFB) is 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 become 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.

Supplemental information associated with debt follows:

Amounts are presented in millions.

	FY 2006		FY 2005
Interest Payable, Federal			
Federal Financing Bank	0		$ 1
Treasury	0		0
Total	**0**		**1**

These interest payable amounts associated with borrowings from Treasury and the FFB are included in the table at the beginning of this note.

	FY 2006		FY 2005
Interest Expense, Federal			
Federal Financing Bank	$ 1,021		$ 1,240
Treasury	1,832		1,784
Total	**$ 2,853**		**$ 3,024**

NOTE 11: STOCK PAYABLE TO RTB BORROWERS

Amounts are presented in millions.

	FY 2006		FY 2005
With the Public			
B Stock Payable	$ 0		$ 481
C Stock Payable	0		909
Total	**$ 0**		**$ 1,390**

These liabilities are long-term in nature.

Capital Stock Class B & C:
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 may exchange Class B stock for Class C stock: 1) upon retiring all debt with RTB; or 2) effective November 9, 1999, prior to retiring all debt on a proportionate basis equal to the percentage of each note repaid. Otherwise, the borrower retains possession of the stock.

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.

The adoption of RTB Resolution 2005-8 provided that the RTB will conduct no further business beginning October 1, 2005, except that which is necessary to liquidate the Bank's assets. As a result, the RTB discontinued B and C stock transactions as of October 1, 2005, with the exception of the B stock patronage capital distribution, the reclassification of the $10 million restricted capital, and the final B and C stock distributions. As of September 30, 2006, all outstanding Class B and C stock has been redeemed.

For further details regarding Class B & C Stock, see **Note 3, Capital Stock**, in the Rural Telephone Bank Financial Statements which are issued under separate cover.

For additional information regarding the dissolution of RTB, see **Note 1B, Reporting Entity.**

NOTE 12: OTHER LIABILITIES

Amounts are presented in millions.

	FY 2006				
	Non-Current		**Current**		**Total**
Intragovernmental					
Employer Contributions & Payroll Taxes Payable	$ 0		$ 3		$ 3
Unfunded FECA Liability	0		6		6
Liability for Deposit Funds & Suspense Accounts	0		(4)		(4)
Other Accrued Liabilities	0		6		6
Payable to Treasury General Fund	0		887		887
Total Intragovernmental	**0**		**898**		**898**
Dividends Payable	0		0		0
Liability for Deposit Funds and Suspense Accounts	0		103		103
Unfunded Annual Leave	0		36		36
Other Accrued Liabilities	0		18		18
Other	19		(12)		7
Total Other Liabilities	**$ 19**		**$ 1,043**		**$ 1,062**

	FY 2005				
	Non-Current		Current		Total
Intragovernmental					
Employer Contributions & Payroll Taxes Payable	$ 0		$ 4		$ 4
Unfunded FECA Liability	0		5		5
Liability for Deposit Funds & Suspense Accounts	0		(7)		(7)
Other Accrued Liabilities	0		16		16
Payable to Treasury General Fund	0		1,273		1,273
Total Intragovernmental	**0**		**1,291**		**1,291**
Dividends Payable	0		50		50
Liability for Deposit Funds and Suspense Accounts	0		92		92
Unfunded Annual Leave	0		27		27
Other Accrued Liabilities	0		18		18
Other	19		(11)		8
Total Other Liabilities	**$ 19**		**$ 1,467**		**$ 1,486**

These liabilities are covered by Budgetary Resources.

NOTE 13: COMMITMENTS AND CONTINGENCIES

COMMITMENTS

Rural Development has commitments under cancelable leases for office space. The majority of buildings in which Rural Development operates are leased by the General Services Administration (GSA). GSA charges rent which is intended to approximate commercial rental rates.

As of September 30, 2006 and 2005, there were approximately $2.0 billion and $1.8 billion in commitments to extend loan guarantees, respectively.

As of September 30, 2006 and 2005, there were no obligations due to cancelled appropriations for which there is a contractual commitment for payment.

CONTINGENCIES

The Rural Development mission area is subject to various claims and contingencies related to lawsuits. No amounts have been accrued in the Financial Statements for claims where the amount or probability of judgment is uncertain.

Litigation is pending for which a determination has been made by the Office of General Counsel that it is “reasonably possible” that a $2.8 billion unfavorable outcome is likely. There were no cases in which payment has been deemed probable and for which the amount of potential liability has been estimated. Consequently, nothing has been accrued in the Financial Statements as of September 30, 2006, and 2005, respectively.

Although overall the existing multi-family housing portfolio is in fair to good condition, Rural Development National Office officials have determined that adequate funds have not been accrued to address future maintenance costs. Adequate maintenance programs are necessary or properties and apartment units will physically deteriorate to the point where safety and sanitation will necessitate a general modernization program to maintain their marketability and ultimately compete for tenants. The cost is expected to reach into the hundreds of millions of dollars.

House Resolution 5039, the Saving America’s Rural Housing Act of 2006, was enacted to resolve this problem. The Act enables Rural Development to offer borrowers a financial restructuring plan for the multi-family housing development which may include one or more revitalization benefits.

NOTE 14: SUPPORTING SCHEDULE FOR THE STATEMENT OF NET COST

Amounts are presented in millions.

	FY 2006				
	Mortgage Credit	**Housing Assistance**	**Area & Regional Development**	**Energy Supply & Conservation**	**Consolidated Total**
Intragovernmental Gross Costs:					
Borrowing Interest Expense	$ 692	$ 0	$ 570	$ 1,591	$ 2,853
Other	167	17	75	21	280
Total Intragovernmental Gross Cost	**859**	**17**	**645**	**1,612**	**3,133**
Less: Intragovernmental Earned Revenue **(Note 15)**	146	1	120	81	348
Intragovernmental Net Costs	**713**	**16**	**525**	**1,531**	**2,785**
Gross Costs with the Public:					
Grants	0	953	816	0	1,769
Loan Cost Subsidies	1,058	12	95	(343)	822
Other	660	32	451	(24)	1,119
Total Gross Costs with the Public	**1,718**	**997**	**1,362**	**(367)**	**3,710**
Less: Earned Revenues from the Public **(Note 15)**	1,281	0	679	1,672	3,632
Net Costs with the Public	**437**	**997**	**683**	**(2,039)**	**78**
Net Cost Of Operations	**$ 1,150**	**$ 1,013**	**$ 1,208**	**$ (508)**	**$ 2,863**

	FY 2005				
	Mortgage Credit	**Housing Assistance**	**Area & Regional Development**	**Energy Supply & Conservation**	**Consolidated Total**
Intragovernmental Gross Costs:					
Borrowing Interest Expense	$ 738	$ 0	$ 548	$ 1,738	$ 3,024
Other	175	19	75	21	290
Total Intragovernmental Gross Cost	**913**	**19**	**623**	**1,759**	**3,314**
Less: Intragovernmental Earned Revenue **(Note 15)**	126	1	160	129	416
Intragovernmental Net Costs	**787**	**18**	**463**	**1,630**	**2,898**
Gross Costs with the Public:					
Grants	0	902	908	0	1,810
Loan Cost Subsidies	(434)	7	85	(61)	(403)
Other	181	32	230	(120)	323
Total Gross Costs with the Public	**(253)**	**941**	**1,223**	**(181)**	**1,730**
Less: Earned Revenues from the Public **(Note 15)**	1,499	0	648	1,773	3,920
Net Costs with the Public	**(1,752)**	**941**	**575**	**(1,954)**	**(2,190)**
Net Cost Of Operations	**$ (965)**	**$ 959**	**$ 1,038**	**$ (324)**	**$ 708**

OTHER DISCLOSURES

FUNCTION LEVEL TITLE	SUBFUNCTION LEVEL TITLE	BUDGET SUBFUNCTION CODE	ACTIVITY INCLUDED IN FINANCIAL STATEMENTS (where applicable)	LOAN/GRANT PROGRAMS INCLUDED IN BUDGET SUBFUNCTION CODE
Commerce & Housing	Mortgage Credit	371	Rural Housing Programs	Single Family Housing (Direct & Guaranteed) Multi-Family Housing (Direct & Guaranteed)
Income Security	Housing Assistance	604	Rural Housing Programs	Domestic Farm Labor Grants Very Low-Income Housing Repair Grants Construction Defects Rental Assistance Program Other Housing Grants
Community & Regional Development	Area & Regional Development	452	Rural Housing Programs Rural Business Programs Rural Utilities Programs	Rural Community Facility (Direct & Guaranteed) Rural Business & Industry (Direct & Guaranteed) Rural Economic Development (Loans & Grants) Rural Development Loan Funds Rural Water & Environmental (Direct & Guaranteed) Rural Telephone Bank Distance Learning & Telemedicine
Energy	Energy Supply & Conservation	271 272	Rural Utilities Programs	Rural Electric & Telecommunications
Agriculture	Agricultural Research & Services	352	Rural Business Programs	Conservation Loan
National Resources	Water Resources Conservation & Land Management Pollution Control & Abatement	301 302 304	Other	Hazardous Waste Disposal

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 Treasury, shows these activities at their function level.

NOTE 15: EARNED REVENUES

Amounts are presented in millions.

	FY 2006								
	Mortgage Credit		Housing Assistance		Area & Regional Development		Energy Supply & Conservation		Total
Intragovernmental									
Interest Revenue from Treasury	$ 137		$ 0		$ 116		$ 80		$ 333
Other	9		1		4		1		15
Total	**146**		**1**		**120**		**81**		**348**
With the Public									
Interest Revenue	1,266		0		668		1,672		3,606
Other	15		0		11		0		26
Total	**1,281**		**0**		**679**		**1,672**		**3,632**
Total Earned Revenues	**$ 1,427**		**$ 1**		**$ 799**		**$ 1,753**		**$ 3,980**

	FY 2005								
	Mortgage Credit		Housing Assistance		Area & Regional Development		Energy Supply & Conservation		Total
Intragovernmental									
Interest Revenue from Treasury	$ 117		$ 0		$ 156		$ 128		$ 401
Other	9		1		4		1		15
Total	**126**		**1**		**160**		**129**		**416**
With the Public									
Interest Revenue	1,482		0		641		1,773		3,896
Other	17		0		7		0		24
Total	**1,499**		**0**		**648**		**1,773**		**3,920**
Total Earned Revenues	**$ 1,625**		**$ 1**		**$ 808**		**$ 1,902**		**$ 4,336**

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 within 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 1l** and **Note 6**.

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 be 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 Program: The two largest loan programs (single-family housing and rural rental and 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 Program: The main loan program (business and industry) has a statutory basis for a 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 and, 3) cost of Secretary of Agriculture's insurance plus an additional charge to cover losses.

Rural Utilities Program: Water and environmental loans have a statutory basis for a rate which has a range between less than or equal to 5 percent to not greater than the current market yield for outstanding municipal obligations of comparable maturities adjusted to the nearest 1/8 of 1 percent. Telephone cost-of-money loans have a statutory basis for a rate equal to the current cost-of-money to the Federal Government for loans of a similar maturity, but not to exceed 7 percent. Electric municipal rate loans have a statutory basis for a rate equal to the current market yield on outstanding municipal obligations, subject to a 7 percent maximum, with remaining periods to maturity similar to the term selected by the applicant. Telephone and electric hardship rate loans have a statutory basis for a rate of 5 percent. The rate on telephone and electric loans purchased by the Federal Financing Bank shall be the rate applicable to similar loans being made or purchased by the Federal Financing Bank.

Exchange Transactions with Federal Sources

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 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 exceed the interest income received from borrowers plus any interest income earned from Treasury.

NOTE 16: APPORTIONMENT CATEGORIES OF OBLIGATIONS INCURRED

Amounts are presented in millions.

	FY 2006				
	Direct		**Reimbursable**		**Total**
Category A	$ 10,782		$ 0		$ 10,782
Category B	7,191		523		7,714
Total Obligations Incurred	**$ 17,973**		**$ 523**		**$ 18,496**

	FY 2005				
	Direct		**Reimbursable**		**Total**
Category A	$ 12,213		$ 0		$ 12,213
Category B	2,998		520		3,518
Total Obligations Incurred	**$ 15,211**		**$ 520**		**$ 15,731**

NOTE 17: AVAILABLE BORROWING AUTHORITY, END OF PERIOD

As of September 30, 2006 and 2005, the amount of available borrowing authority was $18.5 billion and $18.4 billion, respectively.

NOTE 18: TERMS OF BORROWING AUTHORITY USED

Requirements for repayments of borrowings: Borrowings are repaid on Standard 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.

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.

Other 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 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.

NOTE 19: PERMANENT INDEFINITE APPROPRIATIONS

Existence, purpose, and availability of permanent indefinite appropriations: Permanent indefinite appropriations are mainly applicable to liquidating accounts which have the ability for apportionment and the program accounts for reestimates related to upward adjustments of subsidy. 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 for the program accounts by information about the actual performance of a cohort or estimated changes in future cash flows of the cohort.

The period of availability for these appropriations are as follows: (1) Annual authority is available for obligation only during a specified year and expires at the end of that time; (2) Multi-year authority is available for obligation for a specified period of time in excess of one fiscal year; (3) 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 expires 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.

NOTE 20: LEGAL ARRANGEMENTS AFFECTING USE OF UNOBLIGATED BALANCES

The availability/use of budget authority (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 purpose authorized in appropriation acts or other laws.

- **Amount** – Obligations and expenditures may not exceed the amounts established by 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 (**Note 19).**

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

NOTE 21: EXPLANATION OF DIFFERENCES BETWEEN THE STATEMENT OF BUDGETARY RESOURCES (SBR) AND THE BUDGET OF THE UNITED STATES GOVERNMENT

The 2008 Budget of the United States Government, with the Actual Column completed for FY 2006, has not yet been published as of the date of these financial statements. The Budget is currently expected to be published and delivered to Congress in early February 2007. The Budget will be available from the Government Printing Office.

The 2007 Budget of the United States Government, with the Actual Columns completed for FY 2005, was published in February 2006 and reconciled to the SBR. Reconciling items were noted as described in the table below. The reconciling items represent:

- Expired budgetary authority available for upward adjustments of obligations, which is excluded from the President's Budget "actual" column per OMB Circular No. A-11 but is included in the SBR.

- Shared accounts, which represent designated fund account symbols by the USDA, are used to receive and subsequently obligate and disburse. The allotments are treated as nonexpenditure transactions. These accounts retain the fund account symbol identified with the original appropriation from which monies were advanced.

- Amounts due to rounding.

- A reporting error was noted and adjustments were made to the FACTS II submission subsequent to the SBR being published. The error is a result of activity being incorrectly recorded to Unpaid Delivered Orders for the payable associated with unbilled accrued interest with the Federal Financing Bank.

Reconciliation Between FY 2005 Statement of Budgetary Resources and the President's Budget

Amounts are presented in millions.

Applicable Line From SBR	Amount from SBR	Applicable Line From President's Budget	Amount From President's Budget	Legitimate Differences	Reporting Errors
Total Budgetary Resources (line 7)	$22,209	Total budgetary resources available for obligation	$22,038	$171 E - 169 R - 1 S - 1	None
Obligations Incurred (Line 8)	$15,731	Total new obligations	$15,645	$ 84 E - 82 R - 2 S - 0	A = $2
Offsetting Receipts (Line 18)	$ 538	Treasury Combined Statement (Receipts by Department)	$ 538	$ 0 R - 0 S - 0	None
Outlays (line 19c)	$ 4,498	Outlays	$ 4,496	$ 2 R - 1 S - 1	None

LEGEND

A = Adjustment for FACTS II submission
E = Expired Budgetary Authority
R = Rounding
S = Shared Accounts

NOTE 22: UNDELIVERED ORDERS AT THE END OF THE PERIOD

As of September 30, 2006 and 2005, the amount of undelivered orders was $24.8 billion and $24.5 billion, respectively. The remaining amount as presented on the financial statement line is attributed to delivered orders.

NOTE 23: EXPLANATION OF RELATIONSHIP BETWEEN LIABILITIES NOT COVERED BY BUDGETARY RESOURCES ON THE BALANCE SHEET AND THE CHANGE IN COMPONENTS REQUIRING OR GENERATING RESOURCES IN FUTURE PERIODS ON THE STATEMENT OF FINANCING

	FY 2006		FY 2005
Current Year Liabilities Not Covered by Budgetary Resources, as Disclosed in **Note 9**	$ 71		$ 62
Prior Year Liabilities Not Covered by Budgetary Resources	(62)		(74)
Increase (Decrease) in Liabilities Not Covered by Budgetary Resources	9		(12)
Upward (Downward) Reestimates of Credit Subsidy Expense	455		(782)
Increase in Exchange Revenue Receivable from the Public	0		1
Other	0		(21)
Components Requiring or Generating Resources in Future Periods, as Reported on the Statement of Financing	$ 464		$ (814)

For FY 2006, the “Other” amount above and the “Other” amount on the Statement of Financing agree.

For FY 2005, the $(21) million amount reported as “Other” above is different from the $(33) million amount reported as “Other” on the Statement of Financing due to the inclusion of $(12) million amount reported above on the line titled, Increase (Decrease) in Liabilities Not Covered By Budgetary Resources, in the overall computation.

The upward (downward) reestimates of credit subsidy expense are recognized expenses even though budgetary resources will be provided in a subsequent period. These credit subsidy reestimates are reported as liabilities covered by budgetary resources since the budget authority to fund the reestimates is permanent and indefinite and no further Congressional action is required to provide the resources.

NOTE 24: DESCRIPTION OF TRANSFERS THAT APPEAR AS A RECONCILING ITEM ON THE STATEMENT OF FINANCING

The Appalachian Regional Commission (ARC) invests in the basic building blocks of sustainable economic development in the 406 counties (13-State Region) which comprise the Appalachian Region. ARC has allocated funds to Rural Development to provide accounting services. As of September 30, 2006 and 2005, the amount of this reconciling item is $15.3 million and $15.0 million, respectively.

The Economic Development Administration's (EDA) Assistance Program provides grants for public works facilities, other financial assistance, and planning and coordination assistance needed to alleviate conditions of substantial and persistent unemployment and underemployment in economically distressed areas and regions. EDA has allocated funds to Rural Development to provide accounting services. As of September 30, 2006 and 2005, the amount of this reconciling item is $1.4 million and $3.6 million, respectively.

NOTE 25: INCIDENTAL CUSTODIAL COLLECTIONS

Amounts are presented in millions.

	Custodial Activity		
	FY 2006		**FY 2005**
Sources of Collections			
Natural Resources Conservation Service Loan Collections	$ 1		$ 1
Total Revenue Collected	**$ 1**		**$ 1**
Disposition of Collections			
Amount Transferred to Treasury Receipt Accounts	$ 1		$ 1
Total Disposition of Revenue	**$ 1**		**$ 1**
Net Custodial Activity	**$ 0**		**$ 0**

REQUIRED SUPPLEMENTARY INFORMATION
Amounts are presented in millions

	2006 Budgetary	2006 Non-Budgetary Credit Program Financing Accounts	2005 Budgetary	2005 Non-Budgetary Credit Program Financing Accounts
	Rural Community Advancement Programs	Rural Community Advancement Programs	Rural Community Advancement Programs	Rural Community Advancement Programs
Budgetary Resources:				
Unobligated Balance brought forward, Oct. 1	$ 223	$ 520	$ 249	$ 510
Recoveries of Prior Year Unpaid Obligations	41	125	44	145
Budget Authority				
Appropriation	901	0	894	0
Borrowing Authority (Notes 17 & 18)	0	1,462	0	1,642
Spending Authority from Offsetting Collections:				
Earned				
Collected	271	977	304	992
Change in Receivables from Federal Sources	0	0	0	0
Change in Unfilled Customer Orders				
Without Advance from Federal Sources	2	10	0	13
Nonexpenditure Transfers, Net, Anticipated & Actual	0	0	0	0
Permanently Not Available	(282)	(567)	(352)	(464)
Total Budgetary Resources	**$ 1,156**	**$ 2,527**	**$ 1,139**	**$ 2,838**
Status of Budgetary Resources:				
Obligations Incurred: (Note 16)				
Direct	$ 865	$ 2,127	$ 916	$ 2,318
Reimbursable	0	0	0	0
Unobligated Balance:				
Apportioned	167	156	136	520
Unobligated Balance Not Available	124	244	87	0
Total Status of Budgetary Resources	**$ 1,156**	**$ 2,527**	**$ 1,139**	**$ 2,838**
Change in Obligated Balance:				
Obligated Balance, Net				
Unpaid Obligations Brought Forward, Oct. 1	$ 2,610	$ 3,943	$ 2,735	$ 3,609
Uncollected Customer Payments from Federal Sources, Brought Forward, Oct. 1	0	(254)	0	(241)
Total Unpaid Obligated Balance, Net	**2,610**	**3.689**	**2,735**	**3,368**
Obligations Incurred, Net	865	2,127	916	2,318
Gross Outlays	(920)	(1,797)	(997)	(1,839)
Recoveries of Prior Year Unpaid Obligations	(41)	(125)	(44)	(145)
Change in Uncollected Customer Payments from Federal Sources	(2)	(10)	0	(13)
Obligated Balance, Net, End of Period:				
Unpaid Obligations	2,514	4,149	2,610	3,943
Uncollected Customer Payments from Federal Sources	(2)	(265)	0	(254)
Total Unpaid Obligated Balance, Net, End of Period	**$ 2,512**	**$ 3,884**	**$ 2,610**	**$ 3,689**
Net Outlays				
Gross Outlays	$ 920	$ 1,797	$ 997	$ 1,839
Offsetting Collections	(271)	(977)	(304)	(992)
Distributed Offsetting Receipts	(118)	0	(92)	0
Total Net Outlays	**$ 531**	**$ 820**	**$ 601**	**$ 847**

REQUIRED SUPPLEMENTARY INFORMATION

Amounts are presented in millions

	2006 Budgetary	2006 Non-Budgetary Credit Program Financing Accounts	2005 Budgetary	2005 Non-Budgetary Credit Program Financing Accounts
	Rural Electrification/ Telecommunication Funds	Rural Electrification/ Telecommunication Funds	Rural Electrification/ Telecommunication Funds	Rural Electrification/ Telecommunication Funds
Budgetary Resources:				
Unobligated Balance brought forward, Oct. 1	$ 2,313	$ 274	$ 1,745	$ 215
Recoveries of Prior Year Unpaid Obligations	14	358	97	119
Budget Authority				
Appropriation	86	0	280	0
Borrowing Authority (Notes 17 & 18)	0	6,703	0	4,991
Spending Authority from Offsetting Collections:				
Earned				
Collected	1,276	1,725	2,208	1,914
Change in Receivables from Federal Sources	0	0	0	0
Change in Unfilled Customer Orders				
Without Advance from Federal Sources	0	(2)	0	(8)
Nonexpenditure Transfers, Net, Anticipated & Actual	65	0	19	0
Permanently Not Available	(1,925)	(1,382)	(955)	(920)
Total Budgetary Resources	**$ 1,829**	**$ 7,676**	**$ 3,394**	**$ 6,311**
Status of Budgetary Resources:				
Obligations Incurred: (Note 16)				
Direct	$ 723	$ 7,447	$ 1,081	$ 6,037
Reimbursable	0	0	0	0
Unobligated Balance:				
Apportioned	7	229	0	274
Unobligated Balance Not Available	1,099	0	2,313	0
Total Status of Budgetary Resources	**$ 1,829**	**$ 7,676**	**$ 3,394**	**$ 6,311**
Change in Obligated Balance:				
Obligated Balance, Net				
Unpaid Obligations Brought Forward, Oct. 1	$ 236	$ 11,629	$ 318	$ 10,898
Uncollected Customer Payments from Federal Sources, Brought Forward, Oct. 1	0	(43)	0	(50)
Total Unpaid Obligated Balance, Net	**236**	**11,586**	**318**	**10,848**
Obligations Incurred, Net	723	7,447	1,081	6,037
Gross Outlays	(747)	(6,541)	(1,066)	(5,188)
Recoveries of Prior Year Unpaid Obligations	(14)	(358)	(97)	(119)
Change in Uncollected Customer Payments from Federal Sources	0	2	0	8
Obligated Balance, Net, End of Period:				
Unpaid Obligations	198	12,176	236	11,629
Uncollected Customer Payments from Federal Sources	0	(40)	0	(43)
Total Unpaid Obligated Balance, Net, End of Period	**$ 198**	**$ 12,136**	**$ 236**	**$ 11,586**
Net Outlays				
Gross Outlays	$ 747	$ 6,541	$ 1,066	$ 5,188
Offsetting Collections	(1,276)	(1,725)	(2,208)	(1,914)
Distributed Offsetting Receipts	(344)	0	(151)	0
Total Net Outlays	**$ (873)**	**$ 4,816**	**$ (1,293)**	**$ 3,274**

REQUIRED SUPPLEMENTARY INFORMATION

Amounts are presented in millions

	2006 Budgetary		2006 Non-Budgetary Credit Program Financing Accounts		2005 Budgetary		2005 Non-Budgetary Credit Programs Financing Accounts	
	Rural Telephone Bank Funds		Rural Telephone Bank Funds		Rural Telephone Bank Funds		Rural Telephone Bank Funds	
Budgetary Resources:								
Unobligated Balance brought forward, Oct. 1	$	1,472	$	82	$	1,291	$	30
Recoveries of Prior Year Unpaid Obligations		33		258		15		69
Budget Authority								
Appropriation		3		0		5		0
Borrowing Authority (Notes 17 & 18)		0		27		0		235
Spending Authority from Offsetting Collections:								
Earned								
Collected		46		71		244		141
Change in Receivables from Federal Sources		(6)		0		0		0
Change in Unfilled Customer Orders								
Without Advance from Federal Sources		0		(3)		0		0
Nonexpenditure Transfers, Net, Anticipated & Actual		(65)		0		(19)		0
Permanently Not Available		(4)		(380)		(9)		(179)
Total Budgetary Resources	**$**	**1,479**	**$**	**55**	**$**	**1,527**	**$**	**296**
Status of Budgetary Resources:								
Obligations Incurred: (Note 16)								
Direct	$	1,438	$	52	$	55	$	214
Reimbursable		0		0		0		0
Unobligated Balance:								
Apportioned		0		3		0		19
Unobligated Balance Not Available		41		0		1,472		63
Total Status of Budgetary Resources	**$**	**1,479**	**$**	**55**	**$**	**1,527**	**$**	**296**
Change in Obligated Balance:								
Obligated Balance, Net								
Unpaid Obligations Brought Forward, Oct. 1	$	96	$	1,235	$	112	$	1,223
Uncollected Customer Payments from Federal Sources, Brought Forward, Oct. 1		(6)		(18)		(6)		(18)
Total Unpaid Obligated Balance, Net		**90**		**1,217**		**106**		**1,205**
Obligations Incurred, Net		1,438		52		55		214
Gross Outlays		(1,488)		(119)		(56)		(133)
Recoveries of Prior Year Unpaid Obligations		(33)		(258)		(15)		(69)
Change in Uncollected Customer Payments from Federal Sources		6		3		0		0
Obligated Balance, Net, End of Period:								
Unpaid Obligations		13		910		96		1,235
Uncollected Customer Payments from Federal Sources		0		(15)		(6)		(18)
Total Unpaid Obligated Balance, Net, End of Period	**$**	**13**	**$**	**895**	**$**	**90**	**$**	**1,217**
Net Outlays								
Gross Outlays	$	1,488	$	119	$	56	$	133
Offsetting Collections		(46)		(71)		(244)		(141)
Distributed Offsetting Receipts		(28)		0		(10)		0
Total Net Outlays	**$**	**1,414**	**$**	**48**	**$**	**(198)**	**$**	**(8)**

REQUIRED SUPPLEMENTARY INFORMATION

Amounts are presented in millions

	2006 Budgetary	2006 Non-Budgetary Credit Program Financing Accounts	2005 Budgetary	2005 Non-Budgetary Credit Program Financing Accounts
	Rural Housing Funds	Rural Housing Funds	Rural Housing Funds	Rural Housing Funds
Budgetary Resources:				
Unobligated Balance brought forward, Oct. 1	$ 141	$ 1,100	$ 212	$ 1,041
Recoveries of Prior Year Unpaid Obligations	70	95	19	101
Budget Authority				
Appropriation	1,168	0	781	0
Borrowing Authority (Notes 17 & 18)	0	1,411	0	1,442
Spending Authority from Offsetting Collections:				
Earned				
Collected	1,203	2,338	1,404	2,151
Change in Receivables from Federal Sources	0	0	0	0
Change in Unfilled Customer Orders				
Without Advance from Federal Sources	0	(8)	0	(2)
Nonexpenditure Transfers, Net, Anticipated & Actual	0	0	(6)	0
Permanently Not Available	(1,266)	(1,834)	(1,405)	(1,154)
Total Budgetary Resources	**$ 1,316**	**$ 3,102**	**$ 1,005**	**$ 3,579**
Status of Budgetary Resources:				
Obligations Incurred: (Note 16)				
Direct	$ 1,168	$ 2,432	$ 864	$ 2,479
Reimbursable	0	0	0	0
Unobligated Balance:				
Apportioned	48	125	8	644
Unobligated Balance Not Available	100	545	133	456
Total Status of Budgetary Resources	**$ 1,316**	**$ 3,102**	**$ 1,005**	**$ 3,579**
Change in Obligated Balance:				
Obligated Balance, Net				
Unpaid Obligations Brought Forward, Oct. 1	$ 242	$ 808	$ 265	$ 943
Uncollected Customer Payments from Federal Sources, Brought Forward, Oct. 1	0	(238)	0	(240)
Total Unpaid Obligated Balance, Net	**242**	**570**	**265**	**703**
Obligations Incurred, Net	1,168	2,432	864	2,479
Gross Outlays	(1,134)	(2.381)	(868)	(2,513)
Recoveries of Prior Year Unpaid Obligations	(70)	(95)	(19)	(101)
Change in Uncollected Customer Payments from Federal Sources	0	8	0	2
Obligated Balance, Net, End of Period:				
Unpaid Obligations	206	765	242	808
Uncollected Customer Payments from Federal Sources	0	(231)	0	(238)
Total Unpaid Obligated Balance, Net, End of Period	**$ 206**	**$ 534**	**$ 242**	**$ 570**
Net Outlays				
Gross Outlays	$ 1,134	$ 2,381	$ 868	$ 2,513
Offsetting Collections	(1,203)	(2,338)	(1,404)	(2,151)
Distributed Offsetting Receipts	(188)	0	(278)	0
Total Net Outlays	**$ (257)**	**$ 43**	**$ (814)**	**$ 362**

REQUIRED SUPPLEMENTARY INFORMATION

Amounts are presented in millions

	2006 Budgetary		2006 Non-Budgetary Credit Program Financing Accounts		2005 Budgetary		2005 Non-Budgetary Credit Program Financing Accounts	
	Rental Assistance Programs		Rental Assistance Programs		Rental Assistance Programs		Rental Assistance Programs	
Budgetary Resources:								
Unobligated Balance brought forward, Oct. 1	$	1	$	0	$	2	$	0
Recoveries of Prior Year Unpaid Obligations		1		0		0		0
Budget Authority								
Appropriation		730		0		654		0
Borrowing Authority (Notes 17 & 18)		0		0		0		0
Spending Authority from Offsetting Collections:								
Earned								
Collected		0		0		0		0
Change in Receivables from Federal Sources		0		0		0		0
Change in Unfilled Customer Orders								
Without Advance from Federal Sources		0		0		0		0
Nonexpenditure Transfers, Net, Anticipated & Actual		0		0		6		0
Permanently Not Available		(68)		0		(68)		0
Total Budgetary Resources	**$**	**664**	**$**	0	**$**	**594**	**$**	0
Status of Budgetary Resources:								
Obligations Incurred: (Note 16)								
Direct	$	649	$	0	$	593	$	0
Reimbursable		0		0		0		0
Unobligated Balance:								
Apportioned		9		0		0		0
Unobligated Balance Not Available		6		0		1		0
Total Status of Budgetary Resources	**$**	**664**	**$**	0	**$**	**594**	**$**	0
Change in Obligated Balance:								
Obligated Balance, Net								
Unpaid Obligations Brought Forward, Oct. 1	$	2,365	$	0	$	2,595	$	0
Uncollected Customer Payments from Federal Sources, Brought Forward, Oct. 1		0		0		0		0
Total Unpaid Obligated Balance, Net		**2,365**		0		**2,595**		0
Obligations Incurred, Net		649		0		593		0
Gross Outlays		(856)		0		(823)		0
Recoveries of Prior Year Unpaid Obligations		(1)		0		0		0
Change in Uncollected Customer Payments from Federal Sources		0		0		0		0
Obligated Balance, Net, End of Period:								
Unpaid Obligations		2,157		0		2,365		0
Uncollected Customer Payments from Federal Sources		0		0		0		0
Total Unpaid Obligated Balance, Net, End of Period	**$**	**2,157**	**$**	0	**$**	**2,365**	**$**	0
Net Outlays								
Gross Outlays	$	856	$	0	$	823	$	0
Offsetting Collections		0		0		0		0
Distributed Offsetting Receipts		0		0		0		0
Total Net Outlays	**$**	**856**	**$**	0	**$**	**823**	**$**	0

REQUIRED SUPPLEMENTARY INFORMATION

Amounts are presented in millions

	2006 Budgetary		2006 Non-Budgetary Credit Program Financing Accounts		2005 Budgetary		2005 Non-Budgetary Credit Program Financing Accounts	
	Rural Housing Grants		Rural Housing Grants		Rural Housing Grants		Rural Housing Grants	
Budgetary Resources:								
Unobligated Balance brought forward, Oct. 1	$	16	$	0	$	29	$	0
Recoveries of Prior Year Unpaid Obligations		10		0		5		0
Budget Authority								
Appropriation		129		0		126		0
Borrowing Authority (Notes 17 & 18)		0		46		0		3
Spending Authority from Offsetting Collections:								
Earned								
Collected		0		0		0		0
Change in Receivables from Federal Sources		0		0		0		0
Change in Unfilled Customer Orders								
Without Advance from Federal Sources		0		14		0		3
Nonexpenditure Transfers, Net, Anticipated & Actual		0		0		0		0
Permanently Not Available		(1)		(2)		0		0
Total Budgetary Resources	**$**	**154**	**$**	**58**	**$**	**160**	**$**	**6**
Status of Budgetary Resources:								
Obligations Incurred: (Note 16)								
Direct	$	130	$	58	$	144	$	6
Reimbursable		0		0		0		0
Unobligated Balance:								
Apportioned		23		(1)		15		0
Unobligated Balance Not Available		1		1		1		0
Total Status of Budgetary Resources	**$**	154	**$**	**58**	**$**	**160**	**$**	**6**
Change in Obligated Balance:								
Obligated Balance, Net								
Unpaid Obligations Brought Forward, Oct. 1	$	222	$	6	$	184	$	0
Uncollected Customer Payments from Federal Sources, Brought Forward, Oct. 1		0		(3)		0		0
Total Unpaid Obligated Balance, Net		**222**		**3**		**184**		0
Obligations Incurred, Net		130		58		144		6
Gross Outlays		(108)		0		(101)		0
Recoveries of Prior Year Unpaid Obligations		(10)		0		(5)		0
Change in Uncollected Customer Payments from Federal Sources		0		(14)		0		(3)
Obligated Balance, Net, End of Period:								
Unpaid Obligations		234		64		222		6
Uncollected Customer Payments from Federal Sources		0		(17)		0		(3)
Total Unpaid Obligated Balance, Net, End of Period	**$**	**234**	**$**	**47**	**$**	**222**	**$**	**3**
Net Outlays								
Gross Outlays	$	108	$	0	$	101	$	0
Offsetting Collections		0		0		0		0
Distributed Offsetting Receipts		0		0		0		0
Total Net Outlays	**$**	**108**	**$**	0	**$**	**101**	**$**	**0**

REQUIRED SUPPLEMENTARY INFORMATION

Amounts are presented in millions

	2006 Budgetary	2006 Non-Budgetary Credit Program Financing Accounts	2005 Budgetary	2005 Non-Budgetary Credit Program Financing Accounts
	Salaries & Expense	Salaries & Expense	Salaries & Expense	Salaries & Expense
Budgetary Resources:				
Unobligated Balance brought forward, Oct. 1	$ 24	$ 0	$ 36	$ 0
Recoveries of Prior Year Unpaid Obligations	124	0	82	0
Budget Authority				
Appropriation	166	0	149	0
Borrowing Authority (Notes 17 & 18)	0	0	0	0
Spending Authority from Offsetting Collections:				
Earned				
Collected	514	0	507	0
Change in Receivables from Federal Sources	(1)	0	2	0
Change in Unfilled Customer Orders				
Without Advance from Federal Sources	0	0	0	0
Nonexpenditure Transfers, Net, Anticipated & Actual	0	0	0	0
Permanently Not Available	(8)	0	(19)	0
Total Budgetary Resources	**$ 819**	**$ 0**	**$ 757**	$ 0
Status of Budgetary Resources:				
Obligations Incurred: (Note 16)				
Direct	$ 256	$ 0	$ 213	$ 0
Reimbursable	523	0	520	0
Unobligated Balance:				
Apportioned	9	0	2	0
Unobligated Balance Not Available	31	0	22	0
Total Status of Budgetary Resources	**$ 819**	**$ 0**	**$ 757**	$ 0
Change in Obligated Balance:				
Obligated Balance, Net				
Unpaid Obligations Brought Forward, Oct. 1	$ 134	$ 0	$ 131	$ 0
Uncollected Customer Payments from Federal Sources, Brought Forward, Oct. 1	(2)	0	0	0
Total Unpaid Obligated Balance, Net	**132**	**0**	**131**	0
Obligations Incurred, Net	779	0	733	0
Gross Outlays	(670)	0	(648)	0
Recoveries of Prior Year Unpaid Obligations	(124)	0	(82)	0
Change in Uncollected Customer Payments from Federal Sources	1	0	(2)	0
Obligated Balance, Net, End of Period:				
Unpaid Obligations	119	0	134	0
Uncollected Customer Payments from Federal Sources	(1)	0	(2)	0
Total Unpaid Obligated Balance, Net, End of Period	**$ 118**	**$ 0**	**$ 132**	$ 0
Net Outlays				
Gross Outlays	$ 670	$ 0	$ 648	$ 0
Offsetting Collections	(514)	0	(507)	0
Distributed Offsetting Receipts	0	0	0	0
Total Net Outlays	**$ 156**	**$ 0**	**$ 141**	$ 0

REQUIRED SUPPLEMENTARY INFORMATION

Amounts are presented in millions

	2006 Budgetary	2006 Non-Budgetary Credit Program Financing Accounts	2005 Budgetary	2005 Non-Budgetary Credit Program Financing Accounts
	Other	Other	Other	Other
Budgetary Resources:				
Unobligated Balance brought forward, Oct. 1	$ 304	$ 8	$ 187	$ 19
Recoveries of Prior Year Unpaid Obligations	11	23	11	53
Budget Authority				
Appropriation	115	0	108	0
Borrowing Authority (Notes 17 & 18)	0	389	0	162
Spending Authority from Offsetting Collections:				
Earned				
Collected	100	97	71	74
Change in Receivables from Federal Sources	(20)	0	17	0
Change in Unfilled Customer Orders				
Without Advance from Federal Sources	0	(1)	0	(1)
Nonexpenditure Transfers, Net, Anticipated & Actual	37	0	1	0
Permanently Not Available	(196)	(83)	(8)	(91)
Total Budgetary Resources	**$ 351**	**$ 433**	**$ 387**	**$ 216**
Status of Budgetary Resources:				
Obligations Incurred: (Note 16)				
Direct	$ 198	$ 430	$ 83	$ 208
Reimbursable	0	0	0	0
Unobligated Balance:				
Apportioned	(19)	3	201	0
Unobligated Balance Not Available	172	0	103	8
Total Status of Budgetary Resources	**$ 351**	**$ 433**	**$ 387**	**$ 216**
Change in Obligated Balance:				
Obligated Balance, Net				
Unpaid Obligations Brought Forward, Oct. 1	$ 214	$ 875	$ 264	$ 874
Uncollected Customer Payments from Federal Sources, Brought Forward, Oct. 1	(89)	(68)	(72)	(69)
Total Unpaid Obligated Balance, Net	**125**	**807**	**192**	**805**
Obligations Incurred, Net	198	430	83	208
Gross Outlays	(118)	(174)	(122)	(154)
Recoveries of Prior Year Unpaid Obligations	(11)	(23)	(11)	(53)
Change in Uncollected Customer Payments from Federal Sources	20	1	(17)	1
Obligated Balance, Net, End of Period:				
Unpaid Obligations	284	1,107	214	875
Uncollected Customer Payments from Federal Sources	(70)	(66)	(89)	(68)
Total Unpaid Obligated Balance, Net, End of Period	**$ 214**	**$ 1,041**	**$ 125**	**$ 807**
Net Outlays				
Gross Outlays	$ 118	$ 174	$ 122	$ 154
Offsetting Collections	(100)	(97)	(71)	(74)
Distributed Offsetting Receipts	(10)	0	(7)	0
Total Net Outlays	**$ 8**	**$ 77**	**$ 44**	**$ 80**

REQUIRED SUPPLEMENTARY INFORMATION

Amounts are presented in millions

	2006 Budgetary Total	2006 Non-Budgetary Credit Program Financing Accounts Total	2005 Budgetary Total	2005 Non-Budgetary Credit Program Financing Accounts Total
Budgetary Resources:				
Unobligated Balance brought forward, Oct. 1	$ 4,494	$ 1,984	$ 3,751	$ 1,815
Recoveries of Prior Year Unpaid Obligations	304	859	273	487
Budget Authority				
Appropriation	3,298	0	2,997	0
Borrowing Authority (Notes 17 & 18)	0	10,038	0	8,475
Spending Authority from Offsetting Collections:				
Earned				
Collected	3,410	5,208	4,738	5,272
Change in Receivables from Federal Sources	(27)	0	19	0
Change in Unfilled Customer Orders				
Without Advance from Federal Sources	2	10	0	5
Nonexpenditure Transfers, Net, Anticipated & Actual	37	0	1	0
Permanently Not Available	(3,750)	(4,248)	(2,816)	(2,808)
Total Budgetary Resources	**$ 7,768**	**$ 13,851**	**$ 8,963**	**$ 13,246**
Status of Budgetary Resources:				
Obligations Incurred: (Note 16)				
Direct	$ 5,427	$ 12,546	$ 3,949	$ 11,262
Reimbursable	523	0	520	0
Unobligated Balance:				
Apportioned	244	515	362	1,457
Unobligated Balance Not Available	1,574	790	4,132	527
Total Status of Budgetary Resources	**$ 7,768**	**$ 13,851**	**$ 8,963**	**$ 13,246**
Change in Obligated Balance:				
Obligated Balance, Net				
Unpaid Obligations Brought Forward, Oct. 1	$ 6,119	$ 18,496	$ 6,604	$ 17,547
Uncollected Customer Payments from Federal Sources, Brought Forward, Oct. 1	(97)	(624)	(78)	(618)
Total Unpaid Obligated Balance, Net	**6,022**	**17,872**	**6,526**	**16,929**
Obligations Incurred, Net	5,950	12,546	4,469	11,262
Gross Outlays	(6,041)	(11,012)	(4,681)	(9,827)
Recoveries of Prior Year Unpaid Obligations	(304)	(859)	(273)	(487)
Change in Uncollected Customer Payments from Federal Sources	25	(10)	(19)	(5)
Obligated Balance, Net, End of Period:				
Unpaid Obligations	5,725	19,171	6,119	18,496
Uncollected Customer Payments from Federal Sources	(73)	(634)	(97)	(624)
Total Unpaid Obligated Balance, Net, End of Period	**$ 5,652**	**$ 18,537**	**$ 6,022**	**$ 17,872**
Net Outlays				
Gross Outlays	$ 6,041	$ 11,012	$ 4,681	$ 9,827
Offsetting Collections	(3,410)	(5,208)	(4,738)	(5,272)
Distributed Offsetting Receipts	(688)	0	(538)	0
Total Net Outlays	**$ 1,943**	**$ 5,804**	**$ (595)**	**$ 4,555**