



U.S. Department of Agriculture



Office of Inspector General
Financial & IT Operations

Audit Report

Rural Development's Financial Statements for Fiscal Years 2007 and 2006

Report No. 85401-14-FM
November 2007



UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250



November 15, 2007

REPLY TO

ATTN OF: 85401-14-FM

TO: Thomas C. Dorr
Under Secretary
for Rural Development

ATTN: John M. Purcell
Director
Financial Management Division

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

SUBJECT: Rural Development's Financial Statements for Fiscal Years 2007 and 2006

This report presents the results of our audits of Rural Development's financial statements for the fiscal years ending September 30, 2007, and 2006. The report contains a qualified opinion and the results of our assessment of Rural Development's internal control over financial reporting 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 2007 and 2006 (Audit Report No. 85401-14-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, and budgetary resources; (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 direct and 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

During fiscal year 2007, Rural Development made significant revisions to its credit reform processes related to the Single Family Housing Program cash flow model and subsidy reestimates. We were unable to obtain sufficient, appropriate evidence to support Rural Development's financial statement amounts as of September 30, 2007, for estimated allowances for subsidy costs associated with Loans Receivable and Related Foreclosed Property, Net; Other Liabilities, Intragovernmental; Resources Payable to Treasury; and Cumulative Results of Operations reflected on the balance sheet and related note disclosures. We were also unable to obtain sufficient, appropriate evidence to support Rural Development's financial statement amounts for the fiscal year ended September 30, 2007, for loan subsidy expenses and earned revenue associated with Loan Cost Subsidies and Earned Revenues from the Public in the statement of net cost, and Budgetary Financing Sources: Transfers in/out without Reimbursement and Net Cost of Operations on the statement of changes in net position and the related note disclosures. In addition, we attempted to, but were unable to satisfy ourselves as to the amounts of these line items or related note disclosures by alternate auditing procedures.

In our report on the Internal Control Over Financial Reporting, we reported that improvements are needed in Rural Development's (1) financial management of the credit reform processes, (2) information technology (IT), and (3) unliquidated obligation processes.

We believe the first two deficiencies represent material weaknesses. Our report on compliance with laws and regulations continues to disclose an instance of noncompliance related to the Federal Financial Management Improvement Act of 1996.

As discussed in Notes 1 and 22 to the consolidated financial statements, Rural Development changed its method of accounting and reporting for allocation transfers (parent-child relationships) and its method of reporting the reconciliation of budgetary resources obligated to the net cost of operations in fiscal year 2007 to adopt the provisions of OMB Circular No. A-136, *Financial Reporting Requirements*.

Key

Recommendations

We recommended that Rural Development improve its financial reporting controls over credit reform. We did not make additional recommendations related to the other weaknesses since those deficiencies and recommendations were documented in other Office of Inspector General reports.

Agency Response

Rural Development responded that it generally agreed with OIG's findings with respect to improvements being needed in Rural Development's financial management specifically over credit reform, information technology, and unliquidated obligation processes. However, it disagreed that the findings related to the credit reform processes warranting a qualified opinion of Rural Development's financial statements.

OIG Position

We continue to believe that a qualified opinion is warranted because of the lack of sufficient, appropriate evidence with respect to Rural Development's Single Family Housing Program credit reform model and reestimates.

Abbreviations Used in This Report

DLOS	Dedicated Loan Origination and Servicing
DR	Departmental Regulation
FFB	Federal Financing Bank
FFMIA	Federal Financial Management Improvement Act of 1996
FFMSR	Federal Financial Management Systems Requirements
FISMA	Federal Information Security Management Act of 2002
FSA	Farm Service Agency
IT	information technology
ITS	Information Technology Services
NRCS	Natural Resources Conservation Services
OCIO	Office of the Chief Information Officer
OIG	Office of Inspector General
OMB	Office of Management and Budget
SCA	Service Center Agencies
SFH	Single Family Housing
ULO	Unliquidated Obligations

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UNITED STATES DEPARTMENT OF AGRICULTURE
OFFICE OF INSPECTOR GENERAL



Washington D.C. 20250

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, 2007, and 2006, and the related consolidated statements of net cost; and changes in net position; and the combined statements of budgetary resources (hereinafter referred to as the “consolidated financial statements”) for the fiscal years then ended. 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.

Except as discussed in the following paragraph, 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. 07-04, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 07-04 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.

During fiscal year 2007, Rural Development made significant revisions to its credit reform processes related to the Single Family Housing Program cash flow model and subsidy reestimates. We were unable to obtain sufficient, appropriate evidence to support Rural Development’s financial statement amounts as of September 30, 2007, for estimated allowances for subsidy costs associated with Loans Receivable and Related Foreclosed Property, Net; Other Liabilities, Intragovernmental; Resources Payable to Treasury; and Cumulative Results of Operations reflected on the balance sheet and related note disclosures. We were also unable to obtain sufficient, appropriate evidence to support Rural Development’s financial statement amounts for the fiscal year ended September 30, 2007, for loan subsidy expenses and earned revenue associated with Loan Cost Subsidies and Earned Revenues from the Public in the statement of net cost, and Budgetary Financing Sources: Transfers in/out without Reimbursement and Net Cost of Operations on the statement of changes in net position and the related note disclosures. In addition, we attempted to, but were unable to satisfy ourselves as to the amounts of these line items or related note disclosures by alternate auditing procedures.

In our opinion, except for the effects of such adjustments, if any, as might have been necessary had we been able to assess the reasonableness of the consolidated balance sheet, statement of net cost, and statement of changes in net position, and all impacted financial statement line items and related note disclosures referred to in the preceding paragraph, the consolidated financial statements referred to in the first paragraph, present fairly, in all material respects, the financial position of Rural Development as of September 30, 2007, and 2006; and its net costs, changes in net position, and budgetary resources for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Notes 1 and 22 Rural Development changed its reporting requirements for Allocation Transfers and reported all financial activity in its statements as the parent entity whether the amount was material or not. Additionally, as discussed in Note 1 to the consolidated financial statements, Rural Development changed its method of reporting the reconciliation of budgetary resources obligated to the net cost of operations in 2007. These changes were made in accordance with OMB Circular No. A-136, *Financial Reporting Requirements*.

The information in Management's Discussion and Analysis and Required Supplementary Information 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 and OMB Circular No. A-136. 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.

Rural Development's response to the findings identified in our audit is presented in exhibit A. We did not audit the response and, accordingly, we express no opinion on it.

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 9, 2007



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, 2007, and 2006, and the related consolidated statements of net cost and changes in net position, and the combined statements of budgetary resources (hereinafter referred to as the “consolidated financial statements”) for the fiscal years then ended, and have issued our report thereon, dated November 9, 2007. Except as discussed in our opinion, 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. 07-04, *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. 07-04 and *Government Auditing Standards*. We did not test all internal controls as defined by the Federal Managers’ Financial Integrity Act (FMFIA) 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 significant deficiencies. Under standards issued by the American Institute of Certified Public Accountants, significant deficiencies are deficiencies in internal control, or a combination of deficiencies, that adversely affects Rural Development’s ability to initiate, authorize, record, process, or report financial data reliably and in accordance with accounting principles generally accepted in the United States of America such that there is more than a remote likelihood that a misstatement of the financial statements being audited that is more than inconsequential will not be prevented or detected. Material weaknesses are significant deficiencies or a combination of significant deficiencies, that result in more than a remote likelihood that material misstatements in relation to the financial statements being audited will not be prevented or detected. 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 significant deficiencies. We believe that the significant deficiencies in Section 1 are material weaknesses.

Additional Other Procedures

As required by OMB Bulletin No. 07-04, 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. 07-04, 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 FMFIA report.

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 9, 2007



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, 2007, and 2006, and the related consolidated statements of net cost; changes in net position; and the combined statement of budgetary resources (hereinafter referred to as the “consolidated financial statements”) for the fiscal years then ended, and have issued our report thereon, dated November 9, 2007. Except as discussed in our opinion, 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. 07-04, *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, regulations, contracts and agreements, and Governmentwide policy requirements, noncompliance with which could have a direct and material effect on the determination of the consolidated financial statement amounts. We also obtained reasonable assurance that Rural Development complied with certain provision of other laws and regulations specified in OMB Bulletin No. 07-04, including requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996, except for those that, in our judgment, were clearly inconsequential. 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 No. 07-04. (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 9, 2007

Findings and Recommendations

Section 1. Internal Control Over Financial Reporting – Material Weaknesses

Material weaknesses are significant deficiencies, or combinations of significant deficiencies, that result in more than a remote likelihood that material misstatements of the consolidated financial statements will not be prevented or detected. Because of inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected. We believe the findings discussed in this section of the report are material internal control weaknesses.

Finding 1

Improvements Needed in Financial Management of the Credit Reform Processes

We identified deficiencies in Rural Development's credit reform processes related to the revision of its cash flow models and the accuracy of the data used in the models. We attributed these deficiencies to a lack of management oversight and/or quality control of the processes. As a result, Rural Development revised its fiscal year 2007 reestimates, as initially provided for audit, by over \$3.7 billion and recorded 5 quarters of Federal Financing Bank (FFB) interest expense during fiscal year 2007 to include \$281 million that was inappropriately excluded from the fourth quarter expenses of fiscal year 2006. The pervasiveness and the materiality of these deficiencies throughout the cash flows used by Rural Development to perform the credit reform reestimates prevented the Office of Inspector General (OIG) from relying on the internal controls over the reestimates. Further, we were not provided the revised Single Family Housing Program (SFH) model and reestimates until yearend. This prevented us from performing a comprehensive review of the model and adequately reviewing the underlying data associated with the model to ascertain the sufficiency and appropriateness of the evidence supporting the SFH reestimates.

Rural Development hired a contractor to develop a significant revision to the direct SFH cash flow model. Delays were encountered in obtaining the data to support the revised model and a complete SFH model was not provided to OIG for review until late August 2007, well after the March 2007 timeframe initially planned. Although OIG reviewed the revised SFH model and provided written comments on the model, the review was limited due to the fact the model was delivered only 1 month before fiscal yearend. At the end of September 2007, subsequent to the OIG review, Rural Development made additional changes to the SFH cash flows and model. Ultimately, Rural Development provided OIG with version 1 of the fiscal year 2007 SFH reestimates on September 25, 2007, and version 2 of those reestimates on

October 8, 2007. Rural Development had revised the SFH reestimates by over \$2.9 billion between version 1 and version 2. These revisions included Rural Development and OIG identified errors in the data and/or model. OIG's review of this model continues, however as stated above, we are unable to ascertain the sufficiency and appropriateness of the evidence supporting the direct SFH reestimates.

We categorized the credit reform deficiencies into the following four areas: 1) formula errors, 2) version control, 3) model errors, and 4) data inaccuracies within the cash flows or pivot tables. Some of the errors identified were associated with the new fields incorporated in the models. For instance, after submitting the direct housing reestimates, Rural Development identified the housing models had formula errors for the subsidy transfers. Subsidy transfers were also included on the wrong line for guaranteed SFH. Errors and/or revisions in the fiscal year 2007 reestimates and cash flow models were identified for the majority of the material programs reviewed and all of the models reviewed as discussed below.

Program	Amount of Error/Revision
SFH, Direct	\$2.9 billion
Multi-Family Housing, Direct	\$214 million
FFB Electric and Telephone, Direct	\$222 million
SFH and Business and Industry, Guaranteed	\$203 million
Electric Underwriters, Direct	\$124 million
Other Electric, Direct	\$31 million

OIG also identified errors exceeding \$458 million in two of the credit reform note 6 supporting tables (this figure excludes those associated with the reestimate errors identified above).

Our qualified opinion was based on a scope limitation as described above, and as such, we could not determine whether the financial statements' presentation of the accounts identified below were free of material misstatement. In addition, we attempted to, but were unable to satisfy ourselves as to the amounts of these line items or related note disclosures by alternate auditing procedures.

Balance Sheet

Loans Receivable and Related Foreclosed Property, Net
 Other Liabilities, Intragovernmental
 Resources Payable to Treasury
 Cumulative Results of Operations

Statement of Net Cost

Loan Cost Subsidies
Earned Revenues from the Public

Statement of Changes in Net Position

Budgetary Financing Sources: Transfers in/out without Reimbursement
Net Cost of Operations

The U.S. Government Accountability Office's *Standards for Internal Control in the Federal Government* states that application system development and maintenance control provides the structure for safely developing new systems and modifying existing systems. Included are documentation requirements; authorization for undertaking projects; and reviews, testing, and approvals of development and modification activities before placing systems into operation.

The Federal Accounting Standards Advisory Board's Technical Release No. 6, *Preparing Estimates for Direct Loan and Loan Guarantee Subsidies*, dated January 2004, paragraph 36 provides that changes in key factors and assumptions used as a baseline (e.g., disbursement rates, default rates, recovery rates, time periods, etc.) must be explained, supported, and documented. Paragraph 40 states the cash flow estimation process including all underlying assumptions, should be reviewed and approved at the appropriate level including revisions and updates to the original model. Cash flow models should be tested for reliability as part of the approval process by comparing estimated cash flows to actual cash flows and assessing the model's ability to replicate a credit program's performance.

Recommendation 1

Ensure that all new cash flow design models are adequately documented and that quality control reviews are performed by the agency in time to provide for audit.

Recommendation 2

Document and explain any differences identified and provide support for the second party reviews performed.

Recommendation 3

Review data inputs to the reestimate process for accuracy and completeness. This should include documentation of a second party review.

Finding 2

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 was the replacement of aging business and technology systems through IT convergence that would 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 noted.¹ Many of the control 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 reported that certain security program planning and management, access, system software and change controls, and service continuity control objectives were not adequately designed, in place, operational, and/or effectively achieved during the period of our review.

As of the end of fiscal year 2007, OCIO indicated that corrective action had been completed for most of the weaknesses we noted. However, these actions were generally completed on or after June 30, 2007, and were not in place long enough to ensure the controls were consistently and effectively achieved for the year ended September 30, 2007. Additionally, according to OCIO, validation testing was still in progress at fiscal yearend.

¹ Audit Report No. 85401-13-FM, *Rural Development's Financial Statements for Fiscal Years 2006 and 2005*.

Dedicated Loan Origination and Servicing (DLOS) System

In fiscal year 2006, OIG reported weaknesses for DLOS related to management oversight and documentation, system access controls, and application change control.² As of September 30, 2007, two recommendations remained open. In addition, while final action on several other recommendations had not been achieved as of fiscal yearend, it had been achieved as of the end of our fieldwork.

As a result, we concluded that IT weaknesses within Rural Development, taken as a whole, constituted a material internal control weakness for fiscal year 2007. 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 report.

We have made recommendations in prior audits and, therefore, are making no new recommendations in this report with respect to the IT material weaknesses.

² Audit Report No. 85401-13-FM, *Rural Development's Financial Statements for Fiscal Years 2006 and 2005*.

Section 2. Internal Control Over Financial Reporting – Significant Deficiency

Significant deficiencies are matters coming to our attention that, in our judgment, should be communicated because they represent deficiencies that adversely affect the organization's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the consolidated financial statements that is more than inconsequential will not be prevented or detected prior to being certified as valid.

Finding 3

Improvements Needed Over the Rural Telecommunications Program Unliquidated Obligations Certification Process

Additional improvements are necessary in Rural Development's certification process of Rural Electric and Telecommunications Program unliquidated obligations (ULO). We reviewed a statistical sample of 46 Rural Electric and Telecommunications Program ULOs in the amount of about \$682 million, of which 29 were Telecommunications Program records with ULOs in the amount of about \$438 million. Our review disclosed that 23 Telecommunications Program records with ULO balances of over \$316 million were not adequately supported for continued validity prior to being certified as valid. For fiscal year 2007, we also identified about \$50 million in Telecommunications Program ULOs that Rural Development officials had not rescinded as of September 21, 2007. These deficiencies occurred because Telecommunications Program officials did not timely contact borrowers to determine if remaining unadvanced funds were still needed and did not de-obligate records identified for rescission. As a result, certification reports³ were not adequately supported and properly completed. Further, if funds are not de-obligated prior to yearend, Rural Development's fiscal year 2007 Statement of Budgetary Resources could be misstated.

The Department of the Treasury's Fiscal Yearend 2007 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. Departmental Regulation (DR) 2230-001 states that the agency must review all ULOs inactive for 12 months or more and select a dollar majority of inactive ULOs less than 12 months old based on a sample and assess their continued validity. DR 2230-001 states the agencies should perform the

³ 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 de-obligate the funds. The agencies are required document this review and "certify" back to the Department that this was performed.

annual reviews of ULOs for the period ending July 31st. Further, it requires obligations with no activity for the most recent 12 months to be de-obligated unless there is a documented bona-fide purpose for the obligation to remain and a justification for the period of inactivity.

Rural Development officials requested a waiver to DR 2230-001 asserting that the certification procedures outlined in the regulation do not parallel program characteristics since Rural Electric and Telecommunications Programs do not always disburse their loan obligations in the first 2 years. The Office of the Chief Financial Officer granted the waiver allowing Rural Development officials to review and certify 100 percent of all ULOs over 3 years old, regardless of activity. Also, Rural Development received a waiver to continue performing the ULO reviews as of March 31st by May 31st to ensure Rural Development officials maintain the ability to perform a quality review and facilitate meeting OIG's timeline for the financial statement audit.

Rural Development indicated that it had de-obligated the \$50 million prior to yearend. In addition, in accordance with the prior year's response to our recommendation, Rural Development reiterated its commitment to continue taking appropriate actions. Telecommunications Program officials also committed to instituting a strategy to help ensure that funds are timely de-obligated. Therefore, we are not making any additional recommendations in this report.

Section 3. Compliance With Laws and Regulations

The management of Rural Development is responsible for complying with applicable laws and regulations. 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, regulations, contracts and agreements, and Governmentwide policy requirements, noncompliance with which could have a direct and material effect on the determination of the consolidated financial statement amounts. We also obtained reasonable assurance that Rural Development complied with certain provision of other laws and regulations specified in Office of Management and Budget Bulletin No. 07-04, including requirements referred to in the FFMIA, except for those that, in our judgment, were clearly inconsequential. For fiscal year 2007, we continue to report noncompliance with FFMIA.

Finding 4

Noncompliance With FFMIA Requirements

FFMIA requires agencies to annually assess whether their financial management systems comply substantially with (1) Federal Financial Management Systems Requirements (FFMSR), (2) applicable Federal accounting standards, and (3) the U.S. Government Standard General Ledger (SGL) at the transaction level. In addition, the Federal Information Security Management Act (FISMA) requires each agency to report significant information security deficiencies, relating to financial management systems, as a lack of substantial compliance under FFMIA. FFMIA also requires auditors to report in their Chief Financial Officer Act financial statement audit reports whether the financial management systems substantially comply with FFMIA's system requirements.

During fiscal year 2007, Rural Development evaluated its financial management systems to assess compliance with FFMIA. Rural Development reported that it was not substantially compliant with FFMSR and FISMA. Further, Rural Development reported substantial compliance with applicable Federal accounting standards and SGL at the transaction level. OIG concurs with that assessment. The nature and extent as well as the primary cause of the noncompliance are discussed in Finding 2 of this report.

Exhibit A - Agency Response



DEPARTMENT OF AGRICULTURE
OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20250

NOV 13 2007

SUBJECT: Response to Draft Audit Report on Rural Development's
Fiscal Year 2007 Consolidated Financial Statements

TO: Wanda Philippi
Regional Inspector General
Financial and IT Operations Division
Office of the Inspector General
8930 Ward Parkway, Suite 3016
Kansas City, Missouri 64114

Please convey our sincere thanks and appreciation to everyone on your staff who worked diligently on this financial statements audit. We have reviewed the Office of Inspector General (OIG) Draft Report on the Rural Development fiscal year 2007 consolidated financial statements, Report on Internal Control Structure Over Financial Reporting, and the Report on Compliance with Laws and Regulations.

We agree with OIG's findings with respect to improvements being needed in Rural Development's financial management (Credit Reform), information technology, and unliquidated obligation processes. However, we disagree that the findings related to the Credit Reform process warrant a qualified opinion of Rural Development's financial statements. Throughout the course of the audit, Rural Development has coordinated with OIG to substantially correct errors discovered in the subsidy reestimates and models. Accordingly, we believe the statements present fairly the assets, liabilities, net position, net costs, changes in net position, and budgetary resources.

Rural Development will develop a plan of action to address the findings and recommendations identified during the audit. The plan will include the specific actions to be taken on the recommendations and their estimated completion date.

I would like to thank your office for its continuing professionalism in conducting the audit.

A handwritten signature in cursive script that reads "Thomas C. Dorr".

THOMAS C. DORR
Under Secretary
Rural Development

1400 Independence Ave, SW • Washington, DC 20250-0700
Web: <http://www.rurdev.usda.gov>

Committed to the future of rural communities.

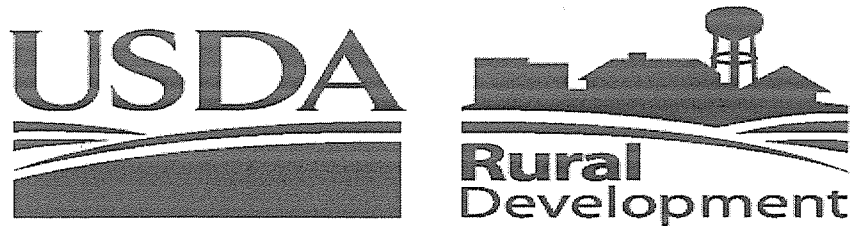
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Washington, DC 20250-9410 or call (800) 795-3272 (voice) or (202) 720-6382 (TDD).
AN EQUAL OPPORTUNITY EMPLOYER

Exhibit B - Consolidated Financial Statements

**USDA
RURAL DEVELOPMENT**

FISCAL YEARS 2007 and 2006

(PREPARED BY RURAL DEVELOPMENT)



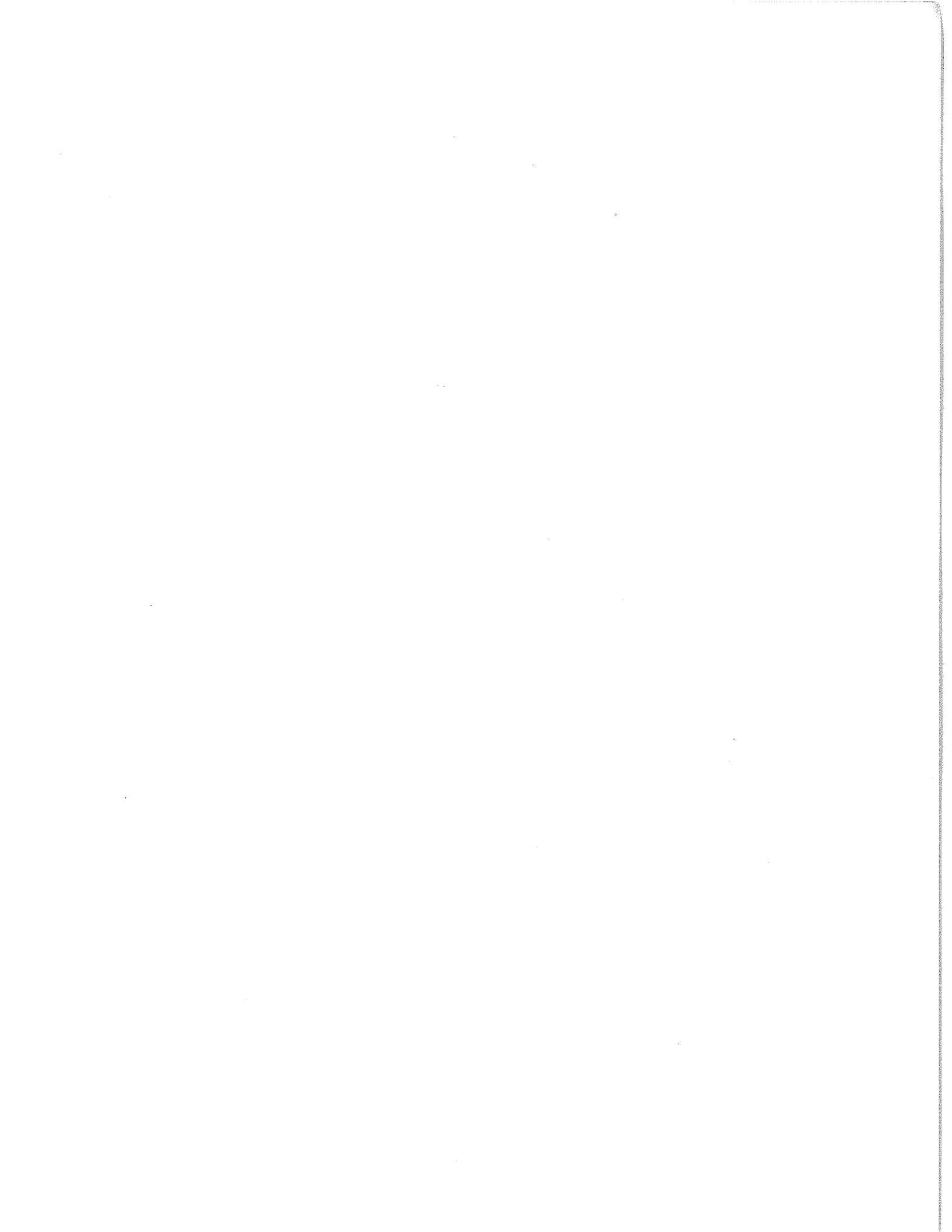
Committed to the future of rural communities.

Consolidated Financial Statements

Fiscal Year 2007 and 2006



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



Rural Development

Management Discussion and Analysis

As of September 30, 2007

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 \$98.9 billion, are delivered through a National Office, 46 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 305,642 SFH borrowers; 15,001 Multi-Family Housing (MFH) borrowers; 11,708 Business and Community borrowers; and 1,871 Telecommunications, Electric, Cable TV, Broadband and Distance Learning and Telemedicine borrowers.

In addition, through a network of approximately 3,000 lenders, Rural Development guarantees loans for approximately 206,063 SFH; 151 MFH; 2,718 business & community service; and 19 electric 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) 2007 than in FY 2006. There was an increase in the direct portfolio from \$74.4 billion to \$76.9 billion and the guaranteed portfolio from \$20.2 billion to \$22.0 billion.

Total Loan Portfolio as of September 30, 2007			
FY's 2005 Through 2007			
(Dollars in Billions)			
	FY 05	FY 06	FY 07
Direct Loans			
Single Family Housing	\$13.2	\$13.0	\$13.0
Multi-Family Housing	11.8	11.6	11.6
Community Facilities/Other	1.9	2.2	2.5
Water & Environmental/Other	8.3	8.7	9.3
Electric	30.1	34.2	36.0
Telecommunications	3.4	3.9	3.9
Rural Telephone Bank	0.6	*	*
Business Programs	0.8	0.8	0.6
<i>Total Direct</i>	70.1	74.4	76.9
Guaranteed Loans			
Single/Multi-Family Housing	14.3	15.3	17.2
Community Facilities/Other	0.5	0.5	0.6
Water & Environmental/Other	0.1	0.1	0.1
Electric	0.4	0.4	0.4
Business Programs	4.2	3.9	3.7
<i>Total Guaranteed</i>	19.5	20.2	22.0
<i>Total Loan Portfolio</i>	\$89.6	\$94.6	98.9\$

*Rural Telephone Bank total loans are included in the Telecommunications totals for FY 2006 and FY 2007.

Rural Development Programs

Rural Business- Cooperative Programs

The purpose of the Rural Business-Cooperative program 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. 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 eligible to receive loans up to \$40 million. The energy programs primary purpose is to stimulate investments in alternative and energy efficiency activity amongst 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)

Rural Business – Business & Industry Guaranteed Loans and Grants	FY 2007 Target	FY 2007 Actual
Delinquency rate (excluding bankruptcy cases)	8%	8.37%
Small Businesses Assisted	8,804	13,120
Millions of kWh generated	1,764	2,924

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 demonstrate an ability to start or expand local businesses, thereby creating employment or saving existing rural jobs.

The Rural Business Enterprise Grant (RBEG) 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 (REDL) and Rural Economic Development Grant (REDG) programs provide loans and grants to Rural Development utility borrowers to promote sustainable rural economic development and job creation projects. Zero percent interest loans are used by electric or telephone utilities to relend to eligible recipients.

The purpose of the Rural Business Opportunity Grants (RBOG) 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 (Section 9006) has awarded over \$107 million in grants and over \$91.5 million in loans since 2003. The cumulative benefits have generated the equivalent of 2.924 million kWh, representing the energy needs of approximately 717,790 homes. This investment has reduced the need for importing 13.52 million barrels of oil and has reduced green house gas emissions equivalent to 1.64 million metric tons. State Rural Development offices promote and screen applicants for both grants and loans.

The Value Added Producer Grant program provides rural producers the opportunity to enhance their share of revenues received for their processed products. Grants can be used for working capital or feasibility studies. These grants to rural businesses for expansion, modernization or start-up, enhances the local job market mix and improves the local tax base. The overall local rural economy is stimulated, jobs created and the quality life improves for most citizens.

The Rural Cooperative Development Grants are being awarded to nonprofit corporations and institutions of higher education to finance up to 75 percent of the cost of establishing and operating Centers for Cooperative Development. These funds help strengthen the rural economy and assist farmers, ranchers, and rural business owners across the nation in establishing and marketing cooperatives.

The Small Minority Agriculture Producer grants are made to Cooperatives or Associations of Cooperatives whose primary focus is to provide assistance to small, minority agriculture producers and whose governing board and/or membership is comprised of at least 75 percent minority. The primary objective of this grant program is to provide technical assistance to small, minority agriculture producers.

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 staffs update and verify the database. The number of jobs is only reported the year the loan is obligated.

During 2007, Socio-Economic Benefit Assessment System, or SEBAS was initiated by Rural Business Staff (RBS) for the Business and Industry (B&I)

program. SEBAS assesses the effectiveness of Rural Development Business and Cooperative B&I program in measures of local and regional economic performance. SEBAS provides an evaluation of the geographic dispersion of the B&I investments' social and economic effects by measuring the impacts at the county, region and state levels. Following the collection of sufficient data, SEBAS will compute indirect hiring, local taxes collected, and the change in Gross Domestic Product (GDP) for funds obligated in each rural county, region, and state. In addition, if subsequent annual operational data is collected on 2007 borrowers, SEBAS will compare projected changes (employment, local taxes, and change in GDP) to actual changes for the same geographic areas each year. The continuous measurement system, SEBAS, has additional analytic capacity.

A second phase was initiated for the Intermediary Relending Program (IRP) and the Energy guaranteed programs. SEBAS will look both at the intermediary's contribution and the ultimate recipient's benefits. The system will look at the Energy loan program in the same manner as the B&I loan program.

Key Performance Indicator(s)

Rural Business-Cooperative Program Create or save jobs	FY 2007 Target	FY 2007 Actual
Total	65,100	76,355

Community Development Programs

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), USDA-Rural Development is a critical partner in successful community development.

USDA-Rural Development often performs two functions in ensuring that a distressed community can develop and implement a successful approach to community development. First, USDA-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 (EZ/EC) program and through the Rural Economic Area Partnership (REAP) Zone program. Second, USDA-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 USDA-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, USDA-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 USDA-Rural Development for the financial resources needed to implement its strategic plan and build a vibrant community.

Key Performance Indicator(s)

Community Development Programs	FY 2007 Target	FY 2007 Actual
Number of jobs created and saved in Rounds I, II and III EZ/EC/CC & REAP Communities	1,500	4,132
Rounds I, II & III EZ/EC/CC & REAP communities' leveraged dollars	\$850,000,000	\$1,969,539,584

The actual numbers presented here come from the Benchmark Management System (BMS). 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 the leveraging of dollars.

Housing & Community Facilities Programs

Single Family Housing

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

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 Single Family Housing Direct (SFH-D) Loan Program has the most loans in the housing portfolio. SFH-D 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-D 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 2007 Target	FY 2007 Actual
Number of rural households receiving financial assistance for housing.	41,230	46,313

In FY 2007, USDA assisted 46,313 households with homeownership opportunities. Of this number, 11,051 were provided through the Section 502 Direct Loan program and 35,262 through the Guaranteed program.

Another 12,386 Very Low income homeowners received assistance with Section 504 repair loans or grants and 397 with subsequent Section 502 Direct loans.

A significant portion of housing program resources continues to be directed to the recovery effort in areas struck by the hurricanes of 2005. Reported homeownership opportunities included assistance provided with Hurricane Supplemental funds. Additionally, households obtained Section 504 Repair loans and grants from special hurricane allocations.

Targets were exceeded in part because of the additional funding available as a result of the hurricane. Reported homeownership opportunities included 3,554 provided with Hurricane Supplemental funds. An additional 878 households obtained Section 504 Repair loans and grants from special hurricane allocations. Also, while the average loan increase remained high (at 5.15 percent) as prices for modest homes remained strong, the increase was less than the 10 percent projected as the housing market continues to cool significantly. Future goals will be adjusted accordingly. However, even as the overall real estate market has cooled, strong demand for both Direct and Guaranteed loans is expected to continue as these programs draw greater interest from lenders and affordable home buyers.

For Direct SFH loans, delinquency rates provide 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 2007 Target	FY 2007 Actual
Delinquency Rate (Direct loans only)	Within 150 basis points of Federal Housing Administration (FHA) Rate	June results are 133 basis points better than FHA.
Delinquency Rate (Guaranteed loans)	Within 75 basis points of FHA Rate	June results are 380 basis points better than FHA

The June, 2007, FHA delinquency rate net of foreclosures was 14.73 percent, with SFH-D at 13.40 percent. This far exceeds the target of being within 150 basis points of the FHA rate. (The June 2007 rate is the latest published FHA statistic. This statistic includes all delinquent loans such as bankruptcies and foreclosures in process for SFH-D and FHA.)

SFH-D year-end (September 30, 2007) delinquency of 14.43 percent is slightly above the previous year rate of 14.27. The increase results from the

weakening in the national housing market and the continuing effect of hurricanes Katrina and Rita as all accounts are no longer receiving payment moratoriums provided after the storms.

The Single Family Housing Guaranteed (SFH-G) loan delinquency rate net of foreclosures was 11.88 percent. The SFH-G rate was 380 basis points better than FHA. The SFH-G loan program significantly exceeds the target for FY 2007. The SFH-G rate is up slightly from the September 2006 rate of 11.60 percent.

It is important to note the Rural Development housing delinquency rate for both the Direct and Guaranteed programs compare favorably to other private and government-sponsored lenders. While the delinquency rates and foreclosures of these lenders have jumped significantly as the 'Sub Prime Lending Crisis' unfolds, Rural Development problem loan statistics remain largely unchanged. Despite serving a similar (or even lower income) clientele, Rural Development has maintained strong underwriting standards and reasonable servicing measures to allow its lower income families to succeed as homeowners.

Multi-Family Housing Programs

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

The farm labor housing program enables farmers, public or private nonprofit organizations, and units of state and local governments to develop or rehabilitate farm labor housing. Seasonal and year-round workers benefit from farm labor housing loans and grants by having safe, affordable housing.

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.

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 2007 Target	FY 2007 Actual
Number of projects with accounts more than 180 days past due	171	188

The MFH portfolio continued its revitalization program; however, the impacts of loan restructuring are a long-term effort. The number of projects with accounts more than 180 days past due was at 188 which, as a percentage of the total portfolio, was within normal parameters (1.1 percent).

Key Performance Indicator(s)

Multi-Family Housing	FY 2007 Target	FY 2007 Actual
Total number of units selected for funding for New Construction	4,186	3,123
Total number of units selected for funding for preservation	8,676	9,477
Decrease in number of families in substandard housing in the MFH portfolio	2,311	2,388
Decrease in number of families in the MFH properties paying more than 30 percent of income in rent	69,500	69,362
Increase the amount of leveraged funds in Rural Rental Housing for both New Construction and rehabilitation	\$428,941,000	\$542,560,325

The number of New Construction units was 3,123, which is a decrease from 2006 because of an increase 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 (GRRH) Loan funds used for New Construction and a greater emphasis on using these guaranteed funds for rehabilitation of existing affordable housing.

The number of units selected for preservation funding was higher than the target by more than 8 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 rehabilitation deals, thereby allowing more units to be renovated per program dollar.

The decrease in the number of families living in substandard housing increased by 77, this was approximately a 4 percent increase from the target. This was primarily attributable to a slight increase in the amount of funding available.

The amount leverage attracted to Multi-Family Housing properties has increased by over 20 percent. An increased emphasis in leveraging preservation transactions helped us in exceeding our goal. A greater emphasis is being paid to attracting additional outside funds to these new construction and preservation transactions.

The number of families paying more than 30 percent of their income towards rent decreased again in FY 2007; the actual number was lower than the target by almost 140 families. The reduction in rent overburdened tenants from FY 2006 to FY 2007 was about 2 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. 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 for housing.

Community Facilities Programs

Community Facilities (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 for purposes of the PART. 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. Data for these measures is derived from actual obligations as reflected in the Guaranteed Loan Accounting System.

Key Performance Indicator(s)

Community Facilities	FY 2007 Target	FY 2007 Actual
Increase the percentage of the rural population with access to improved health care services by 5.5 percent by 2010	1.0%	7.2%
Increase the percentage of the rural population with access to improved safety to 3 percent by 2010	1.3%	6.16%

In spite of a very slow first quarter due to delays in receiving appropriations, CF exceeded its performance targets for the remainder of the year. Obligations became increasingly numerous as the year progressed. We believe this was primarily due to the uncertainty of funding, associated with the fact that many of our facilities are large, complex projects which require significant development time. For the first time, funds in all four of the allocated CF programs (Direct and Guaranteed Loans, Grants, and the Economic Impact Initiative Grants) were fully utilized, thus maximizing the assistance available to our poorest rural communities.

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 Programs

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 864 Distribution and 66 Generation and Transmission cooperatives. Cooperatives serve approximately 40 million people in 47 states, 17 million businesses, homes, schools, churches, farms, irrigation systems, and other establishments in 2,500 of 3,141 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 \$10,565 per mile of line. Investor-owned utilities average 35 customers per mile of line and collect \$62,665 per mile of line, while publicly owned utilities, or municipals, average 47 consumers and collect \$86,302 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 2007 Target	FY 2007 Actual
Number of electric programs borrowers' consumers receiving new or upgraded electric service	8,000,000	5,842,035
Dollar amount of consumers receiving new or upgraded electric service	\$4,157,278,000	\$3,889,764,304

At the time the FY 2007 target for the number of electric programs' borrowers' consumers receiving new or upgraded electric service was established, the anticipated budget amount was approximately \$268 million more than was actually received. This difference in budget between target and actual amounts accounts for some of the difference between the targeted number of consumers and the actual number of consumers. Loans are processed normally in the order in which they are received and complete. It is difficult to estimate which loans and the number of consumers affected by those loans based upon the processing criteria.

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 new construction and upgrades to telecommunications infrastructure. Access to high-speed Internet services and other quality telecommunications services increases educational opportunities, improved availability of healthcare, job creation, retention and growth of businesses and other economic growth.

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 \$2.8 billion in loans have been provided to 188 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. 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.

Key Performance Indicator(s)

Telecommunication	FY 2007 Target	FY 2007 Actual
Number of borrowers' subscribers receiving new and/or improved service	194,699	155,135
Percentage increase of borrowers' subscribers receiving new and/or improved service	5.7%	12.86%
Leveraging of telecommunications financial assistance (private investment to Rural Development funding)	\$4.06:1	\$3.42:1

The Telecommunications Program exceeded the target for percentage increase of borrowers' subscribers receiving new or improved service, although it did not meet its target for number of borrowers' subscribers receiving new or improved service or for leveraging of telecommunications financial assistance. The infrastructure loan program obligations were lower than expected, due to a number of factors. The Telecom Program staff has confirmed with past and prospective borrowers that one important factor was the distribution to current and past borrowers of \$1.4 billion in funds

from the redemption of the stock of the Rural Telephone Bank. This distribution lowered or eliminated the need for many potential borrowers to request external funding. Another factor is regulatory and legislative uncertainty--such as proceedings at the Federal Communications Commission (FCC) and in Congress on Universal Service, Access Charges, Telecom Act re-write and other issues--which have curtailed local exchange carriers from incurring additional debt at this time. Finally, many borrowers have substantial loan reserves. As the program has exhausted its lending levels in recent years, its borrowers have amassed approximately \$3.2 billion in unadvanced loan funds that are available for new construction and improvements. The program staff has met with current and prospective telecommunications infrastructure borrowers to determine their future financing requirements, and will modify requests for funding as necessary. In discussions with individual borrowers and with telecom associations, staff has been told that there is a growing trend toward Internet Protocol Television (IPTV) delivery amongst rural Interexchange Carriers as they attempt to remain competitive in the marketplace. Program staff believes this will require significant upgrades to infrastructure to meet bandwidth requirements.

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 Indicator(s)

Distance Learning and Telemedicine	FY 2007 Target	FY 2007 Actual
Number of schools receiving distance learning facilities	600	699
Number of healthcare providers receiving telemedicine facilities	300	512
Leveraging of telemedicine and distant learning financial assistance (private investment to Rural Development funding)	\$1:\$1	\$1:\$1.60

Performance indicators for the number of schools and healthcare providers receiving distance learning or telemedicine facilities were exceeded. The performance target for leveraging of telemedicine and distance learning financial assistance was not met. The percentage of the total project funds contributed by grant applicants is set at a minimum of 15 percent. The actual percentage varies in each grant cycle and is dependent on the type of projects requested to be financed and the type of applicants applying (e.g. non-profit compared to for profit entities).

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 2007 Target	FY 2007 Actual
The number of borrowers' subscribers receiving new or improved broadband service	55,417	648,418
Percentage growth of borrowers' subscribers receiving new or improved service	15%	141%

The Broadband Program exceeded its performance targets for FY 2007. The program staff's increased outreach activities and support from field staff have resulted in an improvement in the quality of loan applications received. Several large, multi-community loans were approved.

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 2007 Target	FY 2007 Actual
Customers served by new or improved water & waste disposal facilities	557,000	1,332,063

In FY 2007, WEP invested \$1.59 billion in direct and guaranteed loans and grants to provide technical assistance to rural communities and help them develop 1,089 water and waste disposal facilities.

Rural Development anticipated serving 139,250 program borrowers' customers (subscribers) quarterly and 557,000 on an annual basis. Quarterly targets for this measure are based on projected annual measures developed in conformance with The Program Assessment Rating Tool

(PART), and the expected program level to be received each fiscal year. We exceeded our performance targets except for the first quarter when we received limited funding for projects before we received our full budget. We surpassed our goal for FY 2007 by serving 1,332,063 program borrowers' customers (subscribers). Several contributing factors are listed below:

- Rural Development's underwriting tools continue to improve our performance in determining those communities that can afford maximum debt capacity. The result is that the WEP programs reach more communities needing Federal assistance.
- Rural Development uses a "use or lose" policy for funding, which spurs rapid obligation activity over the third and fourth quarters.
- Since creating better output and outcome measurements in response to the recommendations made in the 2003 PART, Rural Development has managed its resources more effectively. Annual measures track the loan to grant mix, leveraged funds for project development, and referrals to commercial credit. With these tracking measures in place, Rural Development is able to target funds to more communities and projects where the financial investments result in a greater number of borrowers' customers being served.
- Rural communities must increase investment in water and wastewater facilities to upgrade aging facilities, meet new quality standards and increase the security of their operations.
- The trend for many water and sewer systems, especially drinking water, is to develop more regional projects that would serve a larger subscriber base.
- In FY 2006, an appropriation of \$45,000,000 was made available for Emergency Hurricane grants. These funds were available for projects in communities affected by a hurricane in calendar year 2005. In FY 2006, \$15 million was obligated; in FY 2007, \$13 million was obligated; and the remaining \$17 million was carried over to FY 2008. It is expected that this balance will be used in FY 2008.

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 Water and Environmental Program 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 pursue the expansion of eGovernment services and capabilities by supporting the USDA Lean Six Sigma initiatives for Transaction Processing, Grants, and Loans. Rural Development's Enterprise Content Management technology is being expanded to support the USDA Lean Six Sigma Transaction processing initiative and Rural Development has been identified as the lead agency within USDA to head the Lean Six Sigma Loans Process initiative. 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. Rural Development also currently offers over 150 forms to the public via the internet. These forms can be completed online and electronically submitted to field service centers for processing.

Rural Development continues to promote web-based business applications and is moving to a Service Oriented Architecture to better support the expansion of these web-based applications. Rural Development took the lead in developing the capability to advertise and sell properties via the internet. This capability of advertisement and sale of farm properties has been extended to the Farm Service Agency (FSA). Rural Development took the lead in developing and deploying a "Homes for Sale" portal with the Department of Housing and Urban Development (HUD) and the Veteran's Administration. Rural Development has also developed and deployed a portal to advertise other federal properties for sale for the General Services Administration.

Rural Development is recognized within USDA as the lead agency in the design and development of enterprise content management technologies and applications and in imaging, scanning, and document management. Software applications developed for use within Rural Development have been enhanced for use throughout USDA and specific capabilities have been added to meet unique Departmental requirements.

Rural Development's Multi-Family Housing (MFH) project management tenant and payment data can now be entered via the internet and rental properties are being advertised to the public via the internet. New MFH

automated rental assistance forecasting tools have been designed, developed, and put into use and will continue to be enhanced. Automation support to centralize the servicing of MFH tenant certification processes and to support MFH project revitalization efforts continue to offer both opportunities and challenges to introduce new state-of-the-art technologies in support of this line of business.

Rural Development continues to promote integrated web-enabled solutions to support the guaranteed loan line of business. Private sector lenders can now enter loan data directly to the guaranteed loan system via a web-enabled front-end application. Automated interfaces with Housing and Urban Development (HUD) and Fannie Mae now support guaranteed loan underwriting processes. The interface with HUD allows direct accessibility to their Total Mortgage Scorecard used for evaluating the credit worthiness of loan applicants. The automation of Single Family Housing loan loss claims is complete. This automation significantly improves the cost effectiveness and efficiency of the delivery of these business processes.

Rural Development continues to enhance the recently operational Socio-Economic Benefits Assessment System (SEBAS) to support the collection, generation, analysis, and reporting of performance measurement data formulated by an economic model developed in collaboration with the University of Missouri. The model assists Rural Development in predicting and assessing the economic impact and effectiveness of rural loan and grant programs.

Within Rural Development, automation efforts continue to improve and expand upon business intelligence reporting and to provide managers and 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 of eligible areas for Rural Development programs are now available to the public. Rural Development has also developed maps reflecting civil rights data for the Department of Agriculture.

Rural Development 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 for access to USDA web applications and services via the internet. This system allows the authorized user to submit forms electronically, complete surveys online, and check 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 Farm Service Agency 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 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.

Delivery Enhancement Team (DET)

USDA, Rural Development administers over 40 programs, each with its own unique regulations, procedures, and forms. This is complicated, confusing, and a barrier to potential applicants. The Delivery Enhancement Team (DET) was challenged to standardize administrative processes and forms across USDA Rural Development's 40-plus programs without consolidating the programs.

Rural Development has an unparalleled delivery system with approximately 800 offices across the country. In order for Rural Development employees to operate across the spectrum of programs, Rural Development needed to simplify and standardize. While simplification is a great asset for program delivery, it also creates a major operational challenge. Each office must be able to address the full range of opportunities offered by Rural Development.

To address these challenges, DET empowered Rural Development staff and expanded the capacity and effectiveness of local offices. From the beginning of the process, DET garnered input from the field and program staff; legal, finance, information technology, training, and regulatory forms staff; USDA's Budget Office, and the Office of Management and Budget (OMB). Their goal was to simplify the process for borrowers and lenders.

Consolidated program regulations should be in the final clearance process by the fall of 2007. The simplified regulations employ a framework for managing portfolio risk, institutional risk, and loss exposure. Standardized reporting requirements and forms across programs will enhance risk assessment, and facilitate the managements and allocation of Agency scarce resources. This will eventually lead to real program savings and lower subsidy scores to enable Rural Development to increase lending relative to budget authority.

Budget and Performance Integration

Budget and Performance Integration is one of the government-wide initiatives in the Presidents Management Agenda. Budget and Performance Integration focuses on performance and the utilization of performance data in the budget decision making process. Rural Development continues to apply the Program Assessment Rating Tool (PART) assessments to select programs. Program Staff develops meaningful program performance measures and methodologies for monitoring the performance of programs relative to the total cost of those programs.

Socio-Economic Benefit Assessment System (SEBAS)

The Economic Research Service, on behalf of USDA-Rural Development, worked with the University of Missouri, Community Policy Analysis Center (CPAC) and the Rural Policy Research Institute (RUPRI) to develop an information system to assess the outcomes and effectiveness of the rural business loan and grant programs. The result is the Socio-Economic Benefits Assessment System (SEBAS). SEBAS can assess the effectiveness of Rural Development business loan investments through the social and economic effects at the county, region, and state levels. Think of dropping a pebble into a pool of water and watching the ripples move through the water.

SEBAS measures loan impact through seven direct and indirect measures of local and regional economic performance to portray the changes in quality of life in rural areas. These performance measures include:

1. Direct Jobs
2. Adjusted Net Jobs
3. Direct full-time equivalent employment
4. Total full-time equivalent employment
5. Total gross domestic product per full-time worker
6. State and local tax revenue

With the current budget realities, increasing requirements for program performance measures, and the changing conditions in rural areas, Rural Development requires up-to-date information on the impact of Rural Development programs. This information must quickly assess the effectiveness of programs in meeting rural needs, and the impacts of other economic, demographic, and policy changes on Rural Development program operations. This information may also enhance Rural

Development and Congressional decisions on program design, funding levels, eligibility criteria, and distribution formulae.

In the future, SEBAS will expand to measure other Rural Development loan and grant programs. Eventually, Rural Development managers at all levels and locales will be able to customize SEBAS to monitor specific program progress and accomplishments.

High Speed Internet Access

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

Changes in Agriculture

While farming continues to be an important component in the economy of many rural areas, the agriculture industry is changing in many ways. In order to increase farm income, 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 utilize by-products for additional sources of income. Authorities granted to Rural Development in the 2002 Farm Bill are targeted to assisting these changes in agriculture.

Renewable Energy Systems and Energy Efficiency Improvements Program (Section 9006)

The emergence of a viable renewable energy market represents a historic opportunity for job and wealth creation in rural America. The 9006 Guaranteed Loan Program encourages the commercial financing of renewable energy—bioenergy, geothermal, hydrogen, solar, and wind—and energy efficiency projects. Under the program, project developers work with local lenders who in turn apply to USDA Rural Development for a loan guarantee up to 85 percent of the loan amount.

Lender benefits include expanding their loan portfolio, making loans above the usual loan limits, protecting the guaranteed portion of loans against loss by the Federal Government, expansion into the existing secondary market for 9006 guarantees, helping to satisfy Community Reinvestment Act (CRA)

requirements, and allowing the use of lenders own familiar forms, loan documents, and security instruments.

The recipient benefits include higher loan amounts, stronger loan applications, lower interest rates, and longer repayment terms that can assist business that may not qualify for conventional lender financing. Agricultural producers and rural small businesses can create energy based income streams as well as reduce their cost of operations via energy efficiency improvements.

The nation gains by a reduction in reliance on foreign oil. The environment wins with a reduction in greenhouse gas emissions.

Multi-Family Housing

Court decisions have given numerous MFH borrowers the opportunity to pay off debt to Rural Development and use the property for something other than housing low income families. As a result, rural America may lose a number of rental housing projects dedicated to low income families. Many tenants living in these properties receive rental assistance through Rural Development, and will lose access to rent subsidies. Rural Development will strive to minimize the impact on the existing tenants, including the provision of vouchers to tenants in those projects that have left the program, and retaining 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 Fiscal Year 2007, Rural Development is reporting a significant internal control weakness associated with the Telecommunications Program unliquidated obligation review and certification process. Rural Development is also reporting a new material internal control weakness relating to the Credit Reform re-estimation process.

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 2007, 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.

Weaknesses existed in Rural Development's ability to control access to sensitive data within the Dedicated Loan Origination and Servicing System.

All corrective actions have been completed as of July 31, 2007 with the exception of Recommendation Number 6. The tasks required to complete this recommendation were more extensive the previously projected.

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.

	Reported in FY 2005	Reported in FY 2006	Reported in FY 2007
Outlays	\$846 M	\$569 M	\$854.5 M
Improper Payment Rate %	3.19 %	3.49 %	3.07 %
Improper Payments \$	\$27 M	\$22 M	\$26.3 M
Year of data sampled	*	*	FY 2006

*FY 2005 and FY 2006 results were based on partial samples of the current fiscal year (FY). Starting with FY 2007 reporting, the statistical sample will be based on the entire prior fiscal year. This will result in both the FY 2006 and FY 2007 results being based on FY 2006 outlays.

The future target rates for improvement are:

Future Targets for Improvement	2008	2009	2010
Estimated Outlays*	\$888.1M	923.7M	960.6M
Improper Payment Rate	3.0%	2.9%	2.8%

*Based on anticipated increase of 4 percent per year

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 a review of Multi-Family Housing tenants receiving rental assistance (RA) payments from a universe of 3,333,206 or .019 percent. This methodology produced a sample with a 99 percent confidence level. The study required field staff to evaluate tenant files and income calculations.

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.

The overall number of errors is less than prior reporting period, although the combined dollar amount is higher. This year, 19 percent of the overpayments were attributed to tenant certifications that were either not signed by the tenant or not in the file. This caused the total amount of RA paid to be considered as improper. This accounts for 78 percent of the overpayments identified. In FY 2006, the overpayments attributed to tenant certifications not signed by the tenant or not in the file was 7 percent.

Other corrective action items include:

1. Errors found in the FY 2007 report must be followed up by Loan Servicing staff for corrective actions.
2. State Offices, with an error rate of 2 percent or higher of the total errors, must develop a corrective action plan. The plan will need to include procedures to train field staff, borrowers and property managers in appropriate required documentation and follow-up with tenants and income-verifiers.
3. An unnumbered letter issued to the State Offices regarding the findings from this report.
4. Management Companies with an error rate of 5 percent or higher of the total errors must provide a corrective action plan to indicate actions they will be undertaking to improve their internal controls for reviewing their tenant file documentation. Scheduled to be implemented by October 31, 2007.
5. The National Office will continue to pursue access to the Health and Human Services (HHS) New Hires data and Housing and Urban Development's

(HUD) Enterprise Income Verification (EIV) System to be shared with State Offices.

6. Add to HB-2-3560, Multi-Family Housing Asset Management Handbook, Chapter 6 – Project Occupancy, a check sheet for property management agents to review when verifying assets, income and adjustments to income. Scheduled to be implemented by November 1, 2007.
7. Add to HB-2-3560, Multi-Family Housing Asset Management Handbook, Chapter 6 – Project Occupancy, a check list of required tenant file documentation. Scheduled to be implemented by November 1, 2007.
8. Develop a “Fact Sheet” for MFH tenants explaining their responsibilities and rights regarding income disclosure and verification. Scheduled to be implemented by November 1, 2007.

Variance Allowances

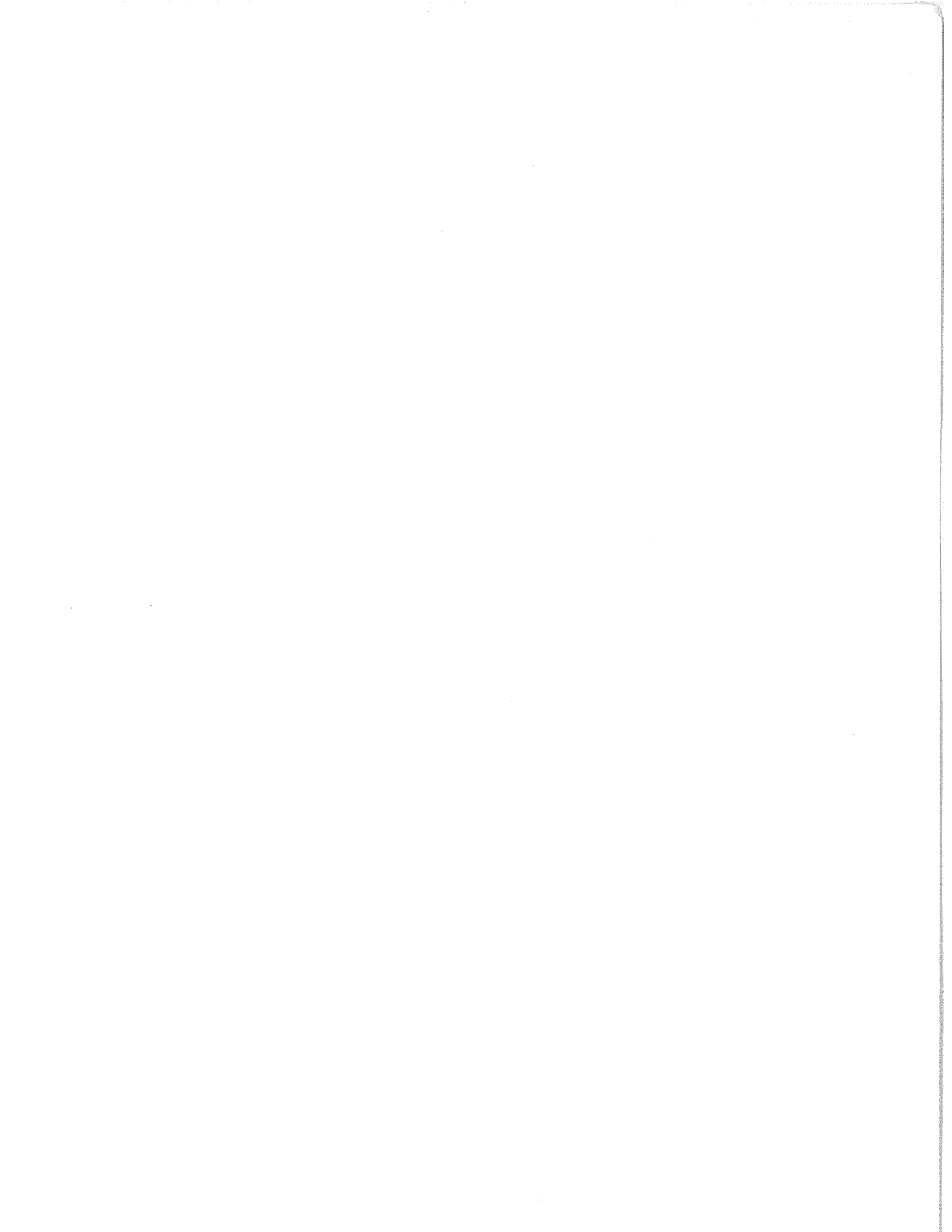
In accordance with Office of Management and Budget (OMB) circular A-136, Financial Reporting Requirements, Rural Development is required to prepare annual analysis of variances in the quarterly financial statements. The variances shown are significant as defined by USDA as those greater than 10 percent and \$100 million for consolidated statements, and greater than 25 percent and \$25 million for components.

Included in this information will be management explanations of significant variances in assets, liabilities, costs, revenues, obligations, and outlays.

Rural Development is reporting a 31 percent decrease in Accounts Payable reflected in the fiscal year 2007 Consolidated Balance Sheet. Two outstanding grant programs that existed at the end of fiscal year 2006 had disbursements in the first quarter of fiscal year 2007. The Water and Environmental Program had grant disbursements of \$20 million, and the Sheep Program had grant disbursements of \$5 million.

The dissolution of the Rural Telephone Bank (RTB) caused a significant decrease in obligations incurred and gross outlays-budgetary. In the last two quarters of FY 2006, approximately \$1.3 billion of B and C stock was obligated and disbursed to the RTB shareholders. This created an outlay for FY 2006 that was not repeated in FY 2007.

The Electric program direct loans were modified in FY 2007. The modification caused an increase of approximately \$1 billion of outlays in the direct financing fund and an increase of collections in the liquidating fund.



**DEPARTMENT OF AGRICULTURE
RURAL DEVELOPMENT
CONSOLIDATED BALANCE SHEET
AS OF SEPTEMBER 30, 2007 AND 2006**
(In Millions)

	<u>2007</u>	<u>2006</u>
Assets (Note 2):		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	\$ 7,778	\$ 8,502
Accounts Receivable, Net (Note 5)	1	1
Total Intragovernmental	<u>7,779</u>	<u>8,503</u>
Cash and Other Monetary Assets (Note 4)	109	98
Accounts Receivable, Net (Note 5)	0	0
Loans Receivable and Related Foreclosed Property, Net (Note 6)	68,372	64,613
General Property, Plant and Equipment, Net (Note 7)	65	68
Other (Note 8)	<u>36</u>	<u>37</u>
Total Assets	<u>76,361</u>	<u>73,319</u>
Liabilities (Note 9):		
Intragovernmental:		
Accounts Payable	3	4
Debt (Note 10)	62,931	59,088
Resources Payable to Treasury (Note 1N)	6,171	6,692
Other (Note 11)	<u>1,320</u>	<u>898</u>
Total Intragovernmental	70,425	66,682
Accounts Payable	64	93
Loan Guarantee Liability (Note 6)	948	954
Debt Held by the Public (Note 10)	0	0
Federal Employee and Veteran Benefits (Note 9)	28	29
Other (Note 11)	<u>173</u>	<u>164</u>
Total Liabilities	71,638	67,922
Commitments and Contingencies (Note 12)		
Net Position:		
Unexpended Appropriations	4,788	5,172
Cumulative Results of Operations	<u>(65)</u>	<u>225</u>
Total Net Position	4,723	5,397
Total Liabilities and Net Position	<u>\$ 76,361</u>	<u>\$ 73,319</u>

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, 2007 AND 2006
(In Millions)**

Cumulative Results of Operations	2007	2006
Beginning Balances:	\$ 225	\$ 543
Adjustments		
Changes in Accounting Principles	0	0
Corrections of Errors	0	0
Beginning Balances, as Adjusted	225	543
Budgetary Financing Sources:		
Appropriations Used	3,039	3,324
Transfers-In/Out Without Reimbursement	(1,573)	(887)
Other Financing Sources:		
Transfers In/Out Without Reimbursement	0	(2)
Imputed Financing	180	110
Total Financing Sources	1,646	2,545
Net Cost of Operations	(1,936)	(2,863)
Net Change	(290)	(318)
Total Cumulative Results of Operations	\$ (65)	\$ 225
 Unexpended Appropriations		
Beginning Balances:	\$ 5,172	\$ 5,207
Adjustments		
Changes in Accounting Principles	(52)	0
Corrections of Errors	0	0
Beginning Balances, as Adjusted	5,120	5,207
Budgetary Financing Sources:		
Appropriations Received	2,822	3,299
Appropriations Transferred In/Out	0	15
Other Adjustments	(115)	(25)
Appropriations Used	(3,039)	(3,324)
Total Budgetary Financing Sources	(332)	(35)
Total Unexpended Appropriations	4,788	5,172
Net Position	\$ 4,723	\$ 5,397

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, 2007 AND 2006**
(In Millions)

	2007	2006
Program Costs (Note 13):		
Intragovernmental Gross Costs	\$	\$
Borrowing Interest Expense	3,758	2,853
Other	362	280
Total Intragovernmental Gross Costs	4,120	3,133
Less: Intragovernmental Earned Revenue (Note 14)	314	348
Intragovernmental Net Costs	3,806	2,785
Gross Costs with the Public:		
Grants	1,736	1,769
Loan Cost Subsidies	193	822
Other	631	1,119
Total Gross Costs with the Public	2,560	3,710
Less: Earned Revenues from the Public (Note 14)	4,430	3,632
Net Costs with the Public	(1,870)	78
Net Cost Of Operations	\$ 1,936	\$ 2,863

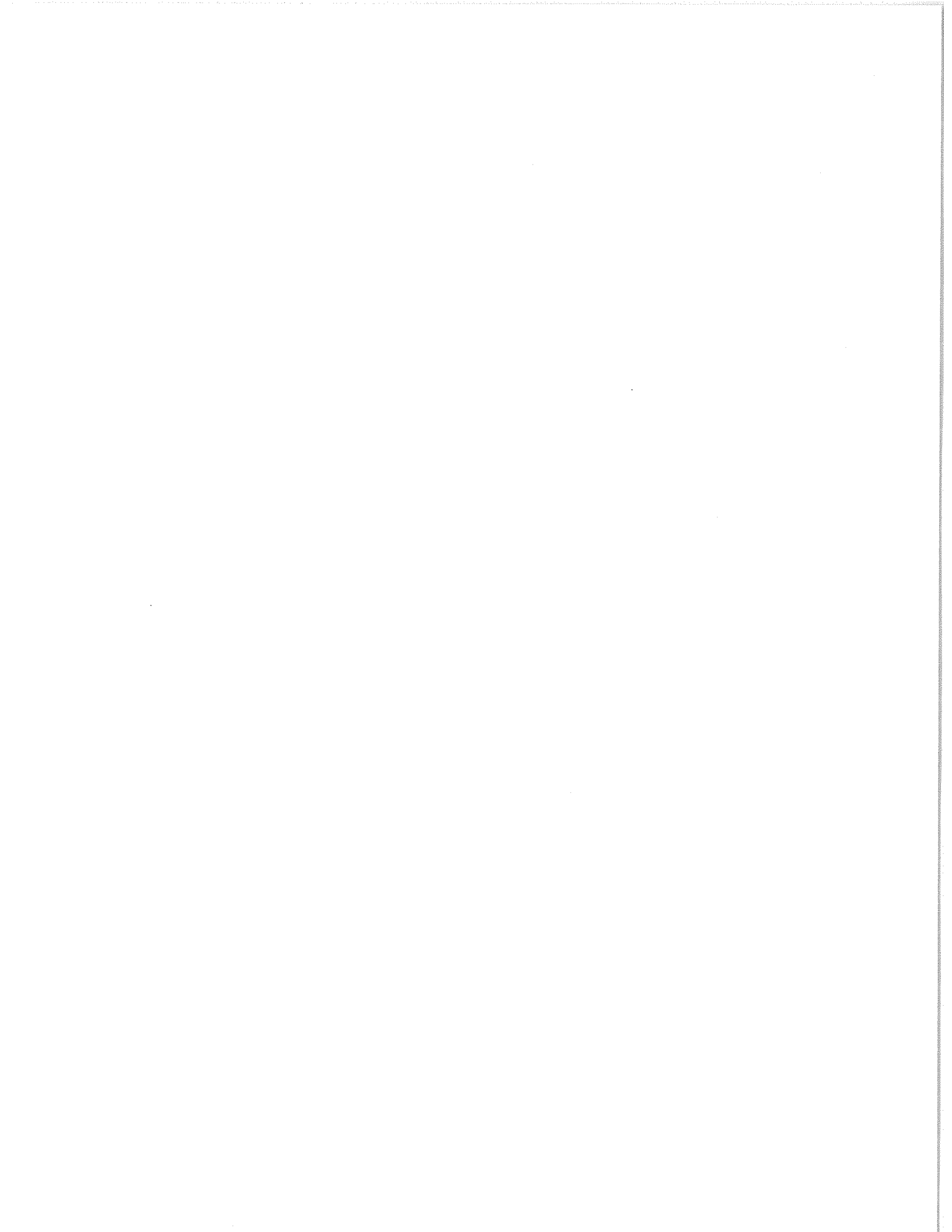
The accompanying notes are an integral part of these statements.

DEPARTMENT OF AGRICULTURE
RURAL DEVELOPMENT
COMBINED STATEMENT OF BUDGETARY RESOURCES
FOR THE YEARS ENDED SEPTEMBER 30, 2007 AND 2006
(In Millions)

	2007		2006	
	Budgetary	Non-Budgetary Credit Program Financing Accts.	Budgetary	Non-Budgetary Credit Program Financing Accts.
Budgetary Resources:				
Unobligated Balance brought forward, Oct. 1	\$ 1,818	\$ 1,305	\$ 4,494	\$ 1,984
Recoveries of Prior Year Unpaid Obligations	169	1,346	304	859
Budget Authority				
Appropriation	2,822	0	3,298	0
Borrowing Authority (Notes 16 & 17)	0	10,846	0	10,038
Spending Authority from Offsetting Collections:				
Earned				
Collected	4,797	5,983	3,410	5,208
Change in Receivables from Federal Sources	(44)	0	(27)	0
Change in Unfilled Customer Orders				
Without Advance from Federal Sources	0	7	2	10
Nonexpenditure Transfers, Net, Anticipated & Actual				
Actual	14	0	37	0
Permanently Not Available	(4,086)	(5,902)	(3,750)	(4,248)
Total Budgetary Resources	\$ 5,490	\$ 13,585	\$ 7,768	\$ 13,851
Status of Budgetary Resources:				
Obligations Incurred: (Note 15)				
Direct	\$ 3,790	\$ 12,338	\$ 5,427	\$ 12,546
Reimbursable	517	0	523	0
Unobligated Balance:				
Apportioned	427	438	244	515
Unobligated Balance Not Available	756	809	1,574	790
Total Status of Budgetary Resources	\$ 5,490	\$ 13,585	\$ 7,768	\$ 13,851
Change in Obligated Balance:				
Obligated Balance, Net				
Unpaid Obligations Brought Forward, Oct. 1	\$ 5,724	\$ 19,171	\$ 6,119	\$ 18,496
Uncollected Customer Payments from Federal Sources, Brought Forward, Oct. 1	(73)	(634)	(97)	(624)
Total Unpaid Obligated Balance, Net	5,651	18,537	6,022	17,872
Obligations Incurred, Net				
Gross Outlays	4,307	12,338	5,950	12,546
Recoveries of Prior Year Unpaid Obligations	(4,452)	(11,794)	(6,041)	(11,012)
Change in Uncollected Customer Payments from Federal Sources	(169)	(1,346)	(304)	(859)
Change in Uncollected Customer Payments from Federal Sources	44	(7)	25	(10)
Obligated Balance, Net, End of Period:				
Unpaid Obligations (Note 21)	5,410	18,369	5,725	19,171
Uncollected Customer Payments from Federal Sources	(29)	(641)	(73)	(634)
Total Unpaid Obligated Balance, Net, End of Period	\$ 5,381	\$ 17,728	\$ 5,652	\$ 18,537
Net Outlays				
Gross Outlays	\$ 4,452	\$ 11,794	\$ 6,041	\$ 11,012
Offsetting Collections	(4,797)	(5,983)	(3,410)	(5,208)
Distributed Offsetting Receipts	(488)	0	(688)	0
Total Net Outlays	\$ (833)	\$ 5,811	\$ 1,943	\$ 5,804

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.



RURAL DEVELOPMENT

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

AS OF SEPTEMBER 30, 2007 AND 2006

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) 2006 column of the financial statements have been reclassified due to evolving changes in the guidance. This reclassification will facilitate a meaningful comparison between FY 2007 and FY 2006.

Footnotes have also been reclassified and additional detail information has been added 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 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.

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 Statement of Budgetary Resources and Reconciliations of Net Cost of Operations to Budget (**Note 24**).

During FY 2007, no new Statement 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, 2007 and 2006, the balance in this account was \$109 million and \$98 million, respectively. This amount has been included in the Consolidated Balance Sheet on the Cash and Other Monetary Assets line and the related footnote (**Note 4**). It has also been included on the Non-Entity Assets (**Note 2**) and Other Liabilities (**Note 11**).

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.

In an effort to more accurately portray the actual value of assets, Rural Development has adopted the USDA policy of writing off, for financial reporting purposes, all loans that are two years or more delinquent.

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 12).

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 (Note 21). 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 and Statement of Changes in Net Position.

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

Hurricanes Katrina and Rita

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. 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**.

S. Allocation Transfers

Rural Development is a party to allocation transfers with other federal agencies as both a transferring entity and a receiving entity. Allocation transfers are legal delegations by one department of its authority to obligate budget authority and outlay funds to another department. A separate fund account is created in the U.S. Treasury as a subset for tracking and reporting purposes. All allocation transfers of balances are credited to this account, and subsequent obligations and outlays incurred by the child entity are charged to this allocation account as they execute the delegated activity on behalf of the parent entity. In FY 2007, the reporting requirements for allocation transfers were changed by OMB Circular A-136. Previously allocation transfers were reported by the parent unless the amount was material to the child. In FY 2007, this changed to require all financial activity related to these allocation transfers to be reported in the financial statements of the parent entity, from which the underlying legislative authority, appropriations and budget apportionments are derived. The appropriate beginning balance amounts in Rural Development FY 2007 financial statements and notes have been changed due to this requirement change (**Note 22**). Rural Development allocates funds, as the parent, to the Small Business Agency and Housing and Urban Development. Rural Development receives allocation transfers, as the child, from the Economic Development Administration, Appalachian Regional Commission, and Delta Regional Authority.

T. Other

In FY 2006, a \$281 million error occurred resulting from activities with the Federal Financing Bank (FFB). The issue was created due to FY 2006 ending on a weekend. As a result, Rural Development remitted the FFB borrower payments on the first business day of the next fiscal year, while FFB recognized the revenue and established a receivable in FY 2006. No accruals were recorded on the Rural Development records until FY 2007. The Balance Sheet, Statement of Net Cost, and Statement of Budgetary Resources were impacted; however, the error was deemed immaterial to the Rural Development Financial Statements and no adjustments were recorded. Summarized below are the changes to the FY 2006 financial statements if the activity would have been correctly recorded.

Balance Sheet

Increase in Loans Receivable and Related Foreclosed Property, Net
Increase in Debt

Net Cost

Increase in Borrowing Interest Expense
Increase in Earned Revenue from the Public

Statement of Budgetary Resources

Increase in Obligations Incurred-Direct
Decrease in Unobligated Balance-Apportioned
Increase in Unpaid Obligations

NOTE 2: NON-ENTITY ASSETS

Amounts are presented in millions.

	FY 2007		FY 2006
With the Public			
Cash and Other Monetary Assets	\$ 109		\$ 98
Total Non-Entity Assets	109		98
Total Entity Assets	76,252		73,221
Total Assets	\$ 76,361		\$ 73,319

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 2007	FY 2006
Fund Balances:		
Revolving Funds	\$ 2,441	\$ 2,728
General Funds	5,338	5,778
Other Fund Types	(1)	(4)
Total	\$ 7,778	\$ 8,502
Status of Fund Balance with Treasury: (FBWT)		
Unobligated Balance:		
Available	\$ 865	\$ 760
Unavailable	1,565	2,365
Obligated Balance Not Yet Disbursed	23,110	24,239
Clearing Account Balances	1	1
Borrowing Authority Not Yet Converted to Fund Balance	(17,481)	(18,530)
Authority Granted Prior to Credit Reform for Rental Assistance Grants	(282)	(333)
Total	\$ 7,778	\$ 8,502

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 2007) 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 2007 and 2006, there were approximately \$58 million and \$53 million in expired funds, respectively.

Total unobligated balances and obligated balances not yet disbursed do not agree with the corresponding fund balance with Treasury amounts presented above, because Rural Development borrows funds from Treasury at the time certain obligations are disbursed. Borrowing authority not yet converted to fund balance represents unobligated and obligated amounts recorded at fiscal yearend, which will be funded by future borrowings.

In addition, amounts presented in the FY 2006 column do not agree to the corresponding line items on the SBR due to OMB reporting requirements for allocation transfers. The difference of \$51 million represents allocation transfer activity with the Economic Development Agency and Appalachian Regional Commission.

NOTE 4: CASH AND OTHER MONETARY ASSETS

Amounts are presented in millions.

	FY 2007		FY 2006
Cash	\$ 109		\$ 98
Total Cash and Other Monetary Assets	\$ 109		\$ 98

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 2007		
	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	2	2	0
Total Accounts Receivable	\$ 3	\$ 2	\$ 1

	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

As of September 30, 2007 and 2006, 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 2007 were \$68 billion compared to \$65 billion at the end of FY 2006. Defaulted guaranteed programs were \$113 million and \$161 million at the end of FY's 2007 and 2006, respectively. Table 1 below illustrates the overall composition of the Rural Development loan portfolio by mission area and loan program for FY 2007 and FY 2006. 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.

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 \$3.2 billion to \$2.7 billion during FY 2007, a decrease of \$0.5 billion. Table 2 shows the reconciliation of subsidy cost allowance balances from FY 2006 to FY 2007.

The largest fluctuations in the subsidy cost allowance in relation to the portfolio for FY 2007 compared to FY 2006 were experienced by the telephone program due to downward reestimates. Direct loan subsidy expense is a component of the subsidy cost allowance. The total direct loan subsidy expense for FY 2007 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 2007 was \$55 million compared to \$690 million in FY 2006, a decrease of \$635 million. The changes are predominately due to reestimate variances in the direct housing and electric loan programs. Changes in the housing credit reform model resulted in a \$906 million subsidy expense decrease while the electric credit reform model experienced a \$281 million increase due to rate assumptions. Table 3 illustrates the breakdown of total subsidy expense, including reestimates, for FY's 2007 and 2006 by program.

Direct loan volume decreased from \$7.8 billion in FY 2006 to \$7.2 billion in FY 2007. Volume distribution between programs is shown in Table 4. The electric loan disbursements accounted for the large decrease in FY 2007.

Table 1

Total Credit Program Receivables and Related Foreclosed Property					
<i>(in millions)</i>					
FY 2007	Loans Receivable, Gross	Interest Receivable	Foreclosed Property	Present Value Allowance	Value of Assets
Direct Loans					
Obligated Pre-1992					
Housing Loans	\$ 10,845	\$ 116	\$ 21	\$ (5,028)	\$ 5,954
Electric Loans	10,045	88	0	(1,373)	8,760
Telecommunications Loans	1,047	3	0	(24)	1,026
Rural Development *	1,608	13	0	(195)	1,426
Development Loan Funds	41	0	0	(19)	22
Other Programs	3	0	0	0	3
Pre-1992 Total	23,589	220	21	(6,639)	17,191
Obligated Post-1991					
Housing Loans	13,680	60	23	(2,007)	11,756
Community Facility Loans	2,342	21	0	(82)	2,281
Electric Loans	26,006	170	0	(42)	26,134
Telecommunications Loans	2,936	6	0	327	3,269
Water and Environmental Loans	7,839	70	0	(638)	7,271
Development Loan Funds	419	2	0	(160)	261
Business & Industry Funds	51	0	0	(38)	13
Economic Development	91	0	0	(8)	83
Post-1991 Total	53,364	329	23	(2,648)	51,068
Total Direct Loan Receivables	76,953	549	44	(9,287)	68,259
Defaulted Guaranteed Loans					
Pre-1992					
Rural Development Insurance Fund	2	1	0	0	3
Post-1991					
Community Facilities	0	0	0	0	0
Business and Industry	118	3	0	(12)	109
Housing Loans	23	0	0	(22)	1
Total Defaulted Guaranteed Loans	\$ 143	\$ 4	\$ 0	\$ (34)	\$ 113
Total Loans Receivable and Related Foreclosed Property, Net					\$ 68,372

* 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					
<i>(in millions)</i>					
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 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
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.

Table 2

Schedule for Reconciling Subsidy Cost Allowance Balances (Post-1991 Direct Loans)		
<i>(in millions)</i>		
Beginning Balance, Changes, and Ending Balance	FY 2007	FY 2006
Beginning Balance of the subsidy cost allowance	\$ 3,177	\$ 2,620
Add: Subsidy expense for direct loans disbursed during the year by component		
Interest rate differential costs	(83)	(149)
Default costs (net of recoveries)	69	43
Fees and other collections	(3)	(3)
Other subsidy costs	292	342
Total of the above subsidy expense components	275	233
Adjustments		
Loan modifications	(3)	1
Fees received	29	21
Loans written off	(225)	(86)
Subsidy allowance amortization	(380)	(89)
Other	26	21
Ending balance of the subsidy cost allowance before reestimates	2,899	2,721
Add or subtract subsidy reestimates by component		
Interest rate reestimates	105	92
Technical/default reestimate	(322)	364
Total of the above reestimate components	(217)	456
Ending balance of the subsidy cost allowance	\$ 2,682	\$ 3,177

Table 3

Direct Loan Subsidy by Program and Component (in millions)										
FY 2007	Subsidy Expense for New Direct Loans Disbursed					Total Modifi- cations	Reestimates			GRAND TOTAL
	Interest Differ- ential	Defaults	Fees and Other Colls.	Other	Total		Interest Rate	Technical	Total	
Direct Loan Programs										
Housing Loans	\$ (170)	\$ 60	\$ (3)	\$ 308	\$ 195	\$ 1	\$ (106)	\$ 3	\$ (103)	\$ 93
Community Facility Loans	17	1	0	(2)	16	0	31	(3)	28	44
Electric Loans	(26)	5	0	(10)	(31)	(4)	122	(108)	14	(21)
Telecommunications Loans	1	2	0	0	3	0	16	(124)	(108)	(105)
Water and Environmental Loans	75	1	0	(3)	73	0	31	(66)	(35)	38
Development Loan Funds	16	0	0	0	16	0	5	(6)	(1)	15
Business & Industry Funds	0	0	0	0	0	0	0	(14)	(14)	(14)
Economic Development	4	0	0	(1)	3	0	6	(4)	2	5
Total Subsidy Expense, Direct Loans	\$ (83)	\$ 69	\$ (3)	\$ 292	\$ 275	\$ (3)	\$ 105	\$ (322)	\$ (217)	\$ 55

Direct Loan Subsidy by Program and Component <i>(in millions)</i>										
FY 2006	Subsidy Expense for New Direct Loans Disbursed					Modifications and Reestimates				GRAND TOTAL
	Interest Differ- ential	Defaults	Fees and Other Colls.	Other	Total	Total Modifi- cations	Interest Rate	Technical	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)
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

Table 4

Total Amount of Direct Loans Disbursed (Post-1991) <i>(in millions)</i>			
Direct Loans	FY 2007	FY 2006	FY 2007 Over (Under) FY 2006
Housing Loans	\$ 1,405	\$ 1,385	\$ 20
Community Facility Loans	451	405	46
Electric Loans	3,814	4,802	(988)
Telecommunications Loans	504	485	19
Water and Environmental Loans	969	675	294
Development Loan Funds	37	36	1
Business & Industry Loans	0	0	0
Economic Development	17	30	(13)
Total Direct Loans Disbursed	\$ 7,197	\$ 7,818	\$ (621)

Guaranteed Loans

Rural Development offers 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 2007 increased compared to the FY 2006 portfolio. At the end of FY 2007 and FY 2006, there were \$22.0 billion and \$20.2 billion in outstanding principal (face value) and \$19.3 billion and \$17.6 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 October 1, 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.

Late in FY 2007, Rural Development identified potential inactive guaranteed loans of \$426 million in outstanding principal (face value) and \$384 million in outstanding principal (guaranteed). In FY 2008, these loans will be researched and reviewed for possible removal from the guaranteed loan portfolio.

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 liability decreased in FY 2007 by \$6 million compared to FY 2006. 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 2007 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 2007 was \$138 million compared to \$132 million in FY 2006, an increase of \$6 million. This increase was mainly due to the guaranteed business

and industry program. Table 7 illustrates the breakdown of total subsidy expense for FY 2007 and FY 2006 by loan program.

Guaranteed loan volume (face value) increased from \$3.7 billion in FY 2006 to \$4.2 billion in FY 2007. The housing loan program experienced the largest increase. 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 2007						
Housing Loans	\$ 6	\$ 17,212	\$ 17,218	\$ 6	\$ 15,491	\$ 15,497
Community Facility Loans	3	660	663	2	584	586
Electric Loans	184	218	402	184	218	402
Business and Industry Loans	14	3,668	3,682	10	2,727	2,737
Water and Environmental	0	37	37	0	30	30
Other Programs	0	0	0	0	0	0
Total Guarantees Disbursed	\$ 207	\$ 21,795	\$ 22,002	\$ 202	\$ 19,050	\$ 19,252
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

Table 6a

Liability for Loan Guarantees <i>(in millions)</i>						
	FY 2007			FY 2006		
	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	\$ 617	\$ 617	\$ 0	\$ 592	\$ 592
Community Facility Loans	0	38	38	0	32	32
Electric Loans	0	0	0	0	0	0
Business and Industry Loans	1	292	293	2	328	330
Water and Environmental Loans	0	0	0	0	0	0
Other Programs	0	0	0	0	0	0
Total Liabilities for Loan Guarantees	\$ 1	\$ 947	\$ 948	\$ 2	\$ 952	\$ 954

Table 6b

Schedule for Reconciling Loan Guarantee Liability <i>(in millions)</i>			
Beginning Balance, Changes, and Ending Balance	FY 2007		FY 2006
Beginning Balance of the loan guarantee liability	\$ 952		\$ 924
Add: Subsidy expense for guaranteed loans disbursed during the year by component			
Interest supplement costs	12		10
Default costs (net of recoveries)	181		154
Fees and other collections	(102)		(92)
Other subsidy costs	0		0
Total of the above subsidy expense components	91		72
Adjustments:			
Loan guarantee modifications	0		0
Fees received	80		67
Interest supplements paid	(1)		(1)
Claim payments to lenders	(76)		(110)
Interest accumulation on the liability balance	(32)		25
Other	(114)		(85)
Ending balance of the loan guarantee liability before reestimates	900		892
Add or subtract subsidy reestimates by component:			
Interest rate reestimate	32		33
Technical/default reestimate	15		27
Total of the above reestimate components	47		60
Ending balance of the loan guarantee liability	\$ 947		\$ 952

Table 7

Guaranteed Loan Subsidy Expense by Program and Component <i>(in millions)</i>										
FY 2007	Subsidy Expense for New Guaranteed Loans Disbursed					Modifications and Reestimates				GRAND TOTAL
	Interest Supplement	Defaults	Fees and Other Colls.	Other	Total	Total Modifi- cations	Interest Rate	Technical	Total	
Guaranteed Loan Programs										
Housing Loans	12	116	(78)	0	50	0	10	(27)	(17)	33
Community Facility Loans	0	10	(2)	0	8	0	2	2	4	12
Electric Loans	0	0	0	0	0	0	0	0	0	0
Business & Industry Loans	0	55	(22)	0	33	0	21	39	60	93
Water & Environmental Loans	0	0	0	0	0	0	(1)	1	0	0
Total Subsidy Expense, Guaranteed Loans	12	181	(102)	0	91	0	32	15	47	138

Guaranteed Loan Subsidy Expense by Program and Component <i>(in millions)</i>										
FY 2006	Subsidy Expense for New Guaranteed Loans Disbursed					Modifications and Reestimates				GRAND TOTAL
	Interest Supplement	Defaults	Fees and Other Colls.	Other	Total	Total Modifi- cations	Interest Rate	Technical	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 Loans	0	57	(25)	0	32	0	13	(4)	9	41
Water & Environmental Loans	0	0	0	0	0	0	0	0	0	0
Total Subsidy Expense, Guaranteed Loans	\$ 10	\$ 154	\$ (92)	\$ 0	\$ 72	\$ 0	\$ 33	\$ 27	\$ 60	\$ 132

Table 8

Guaranteed Loans Disbursed				
<i>(in millions)</i>				
	FY 2007		FY 2006	
	Principal, Face Value Disbursed	Principal, Guaranteed Disbursed	Principal, Face Value Disbursed	Principal, Guaranteed Disbursed
Guaranteed Loans				
Housing Loans	\$ 3,503	\$ 3,152	\$ 3,056	\$ 2,750
Community Facility Loans	140	122	131	114
Electric Loans	0	0	3	3
Business and Industry Loans	588	459	489	382
Water and Environmental Loans	7	6	1	1
Total Guaranteed Loans Disbursed	\$ 4,238	\$ 3,739	\$ 3,680	\$ 3,250

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 utilities 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
- 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 deferrals – loan reamortization – loan transfers
Electric	Maximum 35 years	Current or 5%	Payment deferrals – 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)	Current or 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)			
<i>FY 2007</i>			
Direct Loan Programs	Amount	Guaranteed Loan Programs	Amount
<i>Total</i>	\$ 220		\$ 225
<i>FY 2006</i>			
Direct Loan Programs	Amount	Guaranteed Loan Programs	Amount
<i>Total</i>	\$ 229	<i>Total</i>	\$ 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. Specific models developed and utilized include models for housing, guaranteed, Electric Underwriters, FFB modifications, and a direct model that covers the remaining portfolio with similar characteristics. In FY 2007, reestimates using projected fiscal year activity were recorded in the current fiscal year. In prior years, several programs used an approximator method for financial statement purposes, which lagged one year behind actual budgetary reestimates.

In FY 2007 and FY 2006, Rural Development guaranteed loan programs recorded prior year actual budgetary reestimates and current year activity projected reestimates for material programs. A key sensitivity element in the guaranteed programs is defaults. Fees and other collections are significant in the guaranteed housing and business and industry programs.

An analysis was performed on reestimates and subsidy rates for the direct and guaranteed programs. For FY 2007, the direct telecommunications and housing programs had net downward reestimates of \$108 million and \$103 million, respectively.

A new process was implemented by the Office of Management and Budget (OMB) which required all cash flows be incorporated into the reestimate process. The telephone program incorporated these additional cash flows which resulted in a downward reestimate.

In FY 2006, the housing program implemented a new cash flow model which significantly impacted the reestimates for FY 2006. The model revision in conjunction with the new OMB process implemented in FY 2007 to incorporate all cash flows prohibited a thorough analysis to be performed for timely incorporation into the current financial statements.

Table 7 indicates that the guaranteed programs recorded a \$47 million reestimate expense in the current period. The business and industry program recorded a \$60 million upward reestimate expense due largely to losses incurred in the natural disaster program.

Subsidy rates are used to compute each year's subsidy expense as disclosed in Tables 3 and 7. The subsidy rates disclosed in Tables 11 and 12 pertain only to the FY 2007 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 2007 and FY 2006 and Table 12 has guaranteed program subsidy rates. The direct water and waste disposal program rate changed due to the borrower rates and obligation tiers being established. The subsidy rates for the direct and credit sale single family housing programs were modified to accommodate the new model assumptions.

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 2007, Rural Development modified several loan programs.

Multiple-family housing direct loan program modifications related to the revitalization project, which began in FY 2006, continued throughout FY 2007. 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 rent for tenants who live in such projects.

In FY 2006, electric program direct loans were modified for two borrowers due to damage caused by the hurricanes that 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. One modification in the direct electric program related to the 2005 hurricanes occurred in FY 2007.

In the FFB electric program, loan extension modifications were granted for two borrowers in FY 2007. The maturity dates were extended up to 20 years on selected advances. Interest rates on the advances did not change. At the time of the modification, the liquidating fund was paid off and the advances were moved to the financing fund. The post-modification cash flows were discounted at the third quarter net present value discount factor from the FY 2007 President's Budget relative to the effective date of the loan extension modifications.

Table 11

Subsidy Rates for Direct Loans (Percentage)											
FY 2007						FY 2006					
	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	-14.99	5.37	0.00	19.65	10.03	Section 502 Single-Family Housing	-16.77	2.32	0.00	25.84	11.39
Section 504 Housing Repair	30.08	1.47	0.00	-2.00	29.55	Section 504 Housing Repair	27.00	2.45	0.00	-0.20	29.25
Credit Sales Section 203 (SFH)	-16.88	9.56	0.00	7.80	0.48	Credit Sales Section 203 (SFH)	-19.35	1.16	0.00	3.66	-14.53
Section 514 Farm Labor Housing	45.52	0.21	0.00	2.22	47.95	Section 514 Farm Labor Housing	44.91	0.03	0.00	-0.35	44.59
Section 515 Rural Rental Housing	-18.32	0.07	0.00	63.92	45.67	Section 515 Rural Rental Housing	-17.86	0.04	-0.05	63.75	45.88
Section 523 Self-Help Housing Land Development	2.47	0.00	0.00	0.00	2.47	Section 523 Self-Help Housing Land Development	1.03	0.00	0.00	0.00	1.03
Section 524 Housing Site Development	-2.59	0.93	0.00	0.00	-1.66	Section 524 Housing Site Development	-4.30	0.79	0.00	0.00	-3.51
Credit Sales Section 209 (MFH)	-19.19	0.11	0.00	64.41	45.33	Credit Sales Section 209 (MFH)	-19.82	0.12	0.00	65.10	45.40
Community Facilities	7.04	0.18	0.00	-0.81	6.41	Community Facilities	3.59	0.24	0.00	-0.48	3.35
Distance Learning and Telemedicine	-0.72	1.35	0.00	0.00	0.63	Distance Learning and Telemedicine	0.00	1.63	0.00	-0.13	1.50
Broadband	0.00	2.19	0.00	-0.04	2.15	Broadband	0.00	2.22	0.00	-0.07	2.15
Water & Waste Disposal	10.31	0.09	0.00	-0.44	9.96	Water & Waste Disposal	7.14	0.09	0.00	-0.32	6.91
Electric Hardship	2.25	0.00	0.00	-0.11	2.14	Electric Hardship	0.69	0.02	0.00	0.21	0.92
Electric Municipal	1.26	0.00	0.00	0.25	1.51	Electric Municipal	4.68	0.02	0.00	0.35	5.05
FFB Electric	-1.21	0.02	0.00	0.00	-1.19	FFB Electric	-0.49	0.02	0.00	-0.01	-0.48
Electric Treasury	0.00	0.00	0.00	0.00	0.00	Electric Treasury	0.00	0.02	0.00	-0.01	0.01
Telephone Hardship	0.36	0.01	0.00	0.00	0.37	Telephone Hardship	-1.84	0.02	0.00	0.02	-1.80
Telephone Treasury	0.00	0.03	0.00	0.00	0.03	Telephone Treasury	0.00	0.03	0.00	0.02	0.05
FFB Telephone	-1.21	0.02	0.00	-0.30	-1.49	FFB Telephone	-1.03	0.02	0.00	-0.56	-1.57
Intermediary Relending Program	44.93	0.00	0.00	-0.86	44.07	Intermediary Relending Program	43.84	0.00	0.00	-0.82	43.02
Rural Economic Development	23.45	0.18	0.00	-1.79	21.84	Rural Economic Development	21.40	0.07	0.00	-1.50	19.97
Broadband 4% Loan Program	Not Funded					Broadband 4% Loan Program	5.83	2.13	0.00	-0.01	7.95
Electric Underwriting	-1.24	0.81	0.00	0.00	-0.43	Electric Underwriting	-2.09	0.83	0.00	0.00	-1.26
MFH Preservation	47.81	0.00	0.00	0.01	47.82	MFH Preservation	46.76	0.00	0.00	0.00	46.76

Table 12

Subsidy Rates for Loan Guarantees (Percentage)											
FY 2007						FY 2006					
	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	3.21	-2.00	0.00	1.21	Section 502 Single-Family Housing	0.00	3.16	-2.00	0.00	1.16
Section 502 Single-Family Housing - Refinance	0.00	1.00	-0.50	0.00	0.50	Section 502 Single-Family Housing - Refinance	0.00	0.79	-0.50	0.00	0.29
Section 538 Multi-Family Housing	14.59	0.50	-7.35	0.00	7.74	Section 538 Multi-Family Housing	12.28	0.57	-7.44	0.01	5.42
Community Facilities	0.00	4.52	-0.86	0.00	3.66	Community Facilities	0.00	1.21	-0.85	0.00	0.36
Electric	Not Funded					Electric	0.00	0.09	0.00	0.00	0.09
Business and Industry	0.00	7.40	-3.04	0.00	4.36	Business and Industry	0.00	8.20	-3.41	0.00	4.79
NAD Bank	Not Funded					NAD Bank	0.00	13.76	-3.28	-0.01	10.47
Broadband Loans	Not Funded					Broadband Loans	0.00	3.82	0.00	0.00	3.82
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	8.03	-1.54	0.00	6.49	Renewable Energy	0.00	8.20	-1.75	0.00	6.45

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 2007 and 2006, rural housing program properties consisted primarily of 591 and 530 rural single-family dwellings, respectively. The average holding period for single-family housing properties in inventory for FY's 2007 and 2006 was 23 months and 27 months, respectively. The approximate number of borrowers for which foreclosure proceedings were in process at the end of FY's 2007 and 2006 was 7,300 and 8,300, respectively. Certain properties can be leased to eligible individuals.

Commitments to Guarantee

As of September 30, 2007 and 2006 there were approximately \$2.4 billion and \$2.0 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 \$17.8 billion and \$17.9 billion of the rural housing programs unpaid loan principal as of September 30, 2007 and 2006, 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 \$1.0 billion higher for FY's 2007 and 2006, respectively. At the end of FY's 2007 and 2006, the Rural Development housing portfolio contained approximately 76.5 thousand and 81.0 thousand restructured loans with an outstanding unpaid principal balance of \$2.5 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 2007						
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	92	35	57	2-15	SL	\$ 100,000
Internal Use Software in Development	7	0	7	2-15	SL	\$ 100,000
Total	\$ 104	\$ 39	\$ 65			

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			

* Range of Service Life

** SL - Straight Line

NOTE 8: OTHER ASSETS

Amounts are presented in millions.

	FY 2007		FY 2006
With the Public			
Investment in Loan Asset Sale Trust*	\$ 34		\$ 35
Other	2		2
Total Other Assets	\$ 36		\$ 37

* 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 2007		FY 2006
Intragovernmental			
Unfunded Federal Employees Compensation Act (FECA) Liability	\$ 6		\$ 6
Total Intragovernmental	6		6
With the Public			
Federal Employee and Veteran Benefits	28		29
Unfunded Annual Leave	37		36
Total Liabilities Not Covered by Budgetary Resources	71		71
Total Liabilities Covered by Budgetary Resources	71,567		67,851
Total Liabilities	\$ 71,638		\$ 67,922

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 2006 Beginning Balance	Net Borrowing	FY 2006 Ending Balance	Net Borrowing	FY 2007 Ending Balance
Intragovernmental Debt					
Debt to the Treasury	\$ 31,559	\$ 2,270	\$ 33,829	\$ 3,199	\$ 37,028
Debt to the Federal Financing Bank (FFB)	22,806	2,453	25,259	644	25,903
Total Intragovernmental Debt	54,365	4,723	59,088	3,843	62,931
Agency Debt					
Held by the Public	2	(2)	0	0	0
Notes Payable	0	0	0	0	0
Total Agency Debt	2	(2)	0	0	0
Total Debt	\$ 54,367	\$ 4,721	\$ 59,088	\$ 3,843	\$ 62,931

	FY 2007	FY 2006
Classification of Debt		
Intragovernmental Debt	\$ 62,931	\$ 59,088
Debt Held by the Public	0	0
Total Debt	\$ 62,931	\$ 59,088

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. CBO's outstanding with FFB 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 2007	FY 2006
Interest Payable, Federal		
Federal Financing Bank	\$ 300	\$ 0
Treasury	0	0
Total	\$ 300	\$ 0

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

	FY 2007	FY 2006
Interest Expense, Federal		
Federal Financing Bank	\$ 1,791	\$ 1,021
Treasury	1,967	1,832
Total	\$ 3,758	\$ 2,853

NOTE 11: OTHER LIABILITIES

Amounts are presented in millions.

	FY 2007		
	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	(2)	(2)
Other Accrued Liabilities	0	7	7
Payable to Treasury General Fund	0	1,306	1,306
Total Intragovernmental	0	1,320	1,320
Dividends Payable	0	0	0
Liability for Deposit Funds and Suspense Accounts	0	111	111
Unfunded Annual Leave	0	37	37
Other Accrued Liabilities	0	19	19
Other	19	(13)	6
Total Other Liabilities	\$ 19	\$ 1,474	\$ 1,493

	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

These liabilities are covered by Budgetary Resources.

NOTE 12: 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, 2007 and 2006, there were approximately \$2.4 billion and \$2.0 billion in commitments to extend loan guarantees, respectively.

As of September 30, 2007 and 2006, 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 pending in FY 2007 is three cases in which the outcome has been deemed reasonably possible. The first is a breach of contract case regarding Housing Section 515 loan prepayments. At this time, an amount or range of potential loss cannot be estimated. The second is also a breach of contract case and determination has been made by the Office of General Counsel that it is reasonably possible that a \$9 million unfavorable outcome could result. The third case pending, which was reported in FY 2006 footnotes, is a discrimination complaint filed under the Equal Credit Opportunity Act and the Administrative Procedures Act. A determination has been made by the Office of the General Counsel that it is reasonably possible that a \$2.8 billion unfavorable outcome is likely.

For FY 2007, one breach of contract case regarding Housing Section 515 loan prepayments has been deemed probable; however, at this time legal counsel is unable to make an estimated amount or range of potential loss.

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 13: SUPPORTING SCHEDULE FOR THE STATEMENT OF NET COST

Amounts are presented in millions.

	FY 2007				
	Mortgage Credit	Housing Assistance	Area & Regional Development	Energy Supply & Conservation	Consolidated Total
Intragovernmental Gross Costs:					
Borrowing Interest Expense	\$ 668	\$ 1	\$ 636	\$ 2,453	\$ 3,758
Other	237	21	78	26	362
Total Intragovernmental Gross Cost	905	22	714	2,479	4,120
Less: Intragovernmental Eamed Revenue (Note 14)	107	1	109	97	314
Intragovernmental Net Costs	798	21	605	2,382	3,806
Gross Costs with the Public:					
Grants	2	982	752	0	1,736
Loan Cost Subsidies	111	14	135	(67)	193
Other	301	29	219	82	631
Total Gross Costs with the Public	414	1,025	1,106	15	2,560
Less: Eamed Revenues from the Public (Note 14)	1,121	0	776	2,533	4,430
Net Costs with the Public	(707)	1,025	330	(2,518)	(1,870)
Net Cost Of Operations	\$ 91	\$ 1,046	\$ 935	\$ (136)	\$ 1,936

Amounts are presented in millions.

	FY 2006					Consolidated Total
	Mortgage Credit	Housing Assistance	Area & Regional Development	Energy Supply & Conservation		
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 Eamed Revenue (Note 14)	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: Eamed Revenues from the Public (Note 14)	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

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) 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 14: EARNED REVENUES

Amounts are presented in millions.

	FY 2007				
	Mortgage Credit	Housing Assistance	Area & Regional Development	Energy Supply & Conservation	Total
Intragovernmental					
Interest Revenue from Treasury	\$ 97	\$ 0	\$ 106	\$ 96	\$ 299
Other	10	1	3	1	15
Total	107	1	109	97	314
With the Public					
Interest Revenue	1,113	0	770	2,533	4,416
Other	8	0	6	0	14
Total	1,121	0	776	2,533	4,430
Total Earned Revenues	\$ 1,228	\$ 1	\$ 885	\$ 2,630	\$ 4,744

	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

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 11** 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 15: APPORTIONMENT CATEGORIES OF OBLIGATIONS INCURRED

Amounts are presented in millions.

	FY 2007			
	Direct		Reimbursable	Total
Category A	\$ 8,729		\$ 0	\$ 8,729
Category B	7,399		517	7,916
Total Obligations Incurred	\$ 16,128		\$ 517	\$ 16,645

	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

NOTE 16: AVAILABLE BORROWING AUTHORITY, END OF PERIOD

As of September 30, 2007 and 2006, the amount of available borrowing authority was \$17.5 billion and \$18.5 billion, respectively.

NOTE 17: 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 18: 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 19: 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 18**).

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

The 2009 Budget of the United States Government, with the Actual Column completed for FY 2007, 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 2008. The Budget will be available from the Government Printing Office.

The 2008 Budget of the United States Government, with the Actual Columns completed for FY 2006, was published in February 2007 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.
- The Biomass Research and Development program was transferred to Rural Development during FY 2006 from the National Resources Conservation Service (NRCS). The transferred amounts are reflected in the published SBR, but not in the Budget.
- In FY 2006, Total Net Outlays on the SBR reflect an accounting reduction for Distributed Offsetting Receipts. Also in FY 2006, OMB Circular A-136 required including certain clearing accounts and miscellaneous receipt accounts on the Distributed Offsetting Receipts line.
- Amounts due to rounding.

Reconciliation Between FY 2006 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)	\$21,619	Total budgetary resources available for obligation	\$ 21,409	\$ 210 E - 195 R - 1 S - 1 T - 13	None
Obligations Incurred (Line 8)	\$18,496	Total new obligations	\$ 18,370	\$ 126 E - 112 R - 0 S - 1 T - 13	None
Distributed Offsetting Receipts (Line 19C)	\$ (688)	Treasury Combined Statement (Receipts by Department)	\$ (682)	\$ (6) A - (6) R - 0 S - 0	None
Total Net Outlays (Line 19D)	\$ 7,747	Outlays	\$ 8,441	\$ (694) A - (6) O - (682) R - (2) S - 1 T - (5)	None

LEGEND

A = Adjustment

E = Expired Budgetary Authority

O = Distributed Offsetting Receipts

R = Rounding

S = Shared Accounts

T = Transfer

NOTE 21: UNDELIVERED ORDERS AT THE END OF THE PERIOD

As of September 30, 2007 and 2006, the amount of undelivered orders was \$23.4 billion and \$24.7 billion, respectively. The remaining amount as presented on the financial statement line is attributed to delivered orders. In FY 2006 this amount was inadvertently reported as \$24.8 billion.

NOTE 22: ADJUSTMENTS TO BEGINNING BALANCE OF BUDGETARY RESOURCES

Amounts are presented in millions.

	FY 2007 Obligated	FY 2006 Obligated
Beginning Balances	\$ 24,189	23,894
Adjustments	(1)	0
Beginning Balances, as adjusted	\$ 24,188	23,894

An adjustment to the beginning balance of budgetary resources obligated balance occurred as a result of a change in reporting requirements effective FY 2007 for allocation transfers. In FY 2006, we reported child activity in our financial statements. Beginning in FY 2007, child activity must be reported in the financial statements of the parent entity.

NOTE 23: INCIDENTAL CUSTODIAL COLLECTIONS

Amounts are presented in millions.

	Custodial Activity	
	FY 2007	FY 2006
Sources of Collections		
Natural Resources Conservation Service Loan Collections	\$ 2	\$ 1
Total Revenue Collected	\$ 2	\$ 1
Disposition of Collections		
Amount Transferred to Treasury Receipt Accounts	\$ 2	\$ 1
Total Disposition of Revenue	\$ 2	\$ 1
Net Custodial Activity	\$ 0	\$ 0

NOTE 24: RECONCILIATIONS OF NET COST OF OPERATIONS TO BUDGET

AMOUNTS ARE PRESENTED IN MILLIONS

	2007	2006
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations Incurred	16,645	18,496
Less: Spending Authority from Offsetting Collections and Recoveries	12,258	9,766
Obligations Net Offsetting Collections and Recoveries	4,387	8,730
Less: Offsetting Receipts	488	688
Net Obligations	3,899	8,042
Other Resources		
Transfers In/Out Without Reimbursement	0	(2)
Imputed Financing from Costs Absorbed by Others	180	110
Net Other Resources Used to Finance Activities	180	108
Total Resources Used to Finance Activities	4,079	8,150
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	1,344	(366)
Resources That Fund Expenses Recognized in Prior Periods	(232)	(545)
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	10,216	8,018
Change in Unfilled Customer Orders	7	12
Other	486	682
Resources That Finance the Acquisition of Assets	(12,925)	(13,122)
Other Resources or Adjustments to Net Obligated Resources That Do Not Affect Net Cost of Operations	2	8
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	(1,102)	(5,313)
Total Resources Used to Finance the Net Cost of Operations	2,977	2,837
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	0	9
Upward/Downward Reestimates of Credit Subsidy Expense	(222)	455
Increase in exchange revenue receivable from the public	0	0
Other	0	0
Total Components of Net Cost of Operations That Will Require or Generate Resources in Future Periods	(222)	464
Components Not Requiring or Generating Resources:		
Depreciation and Amortization	16	8
Revaluation of Assets or Liabilities	0	0
Other Components Not Requiring or Generating Resources		
Bad Debt Expense	(816)	(748)
Other	(19)	302
Total Components of Net Cost of Operations That Will Not Require or Generate Resources	(819)	(438)
Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period	(1,041)	26
Net Cost of Operations	\$ 1,936	\$ 2,863

REQUIRED SUPPLEMENTARY INFORMATION

Amounts are presented in millions

	2007 Budgetary	2007 Non-Budgetary Credit Program Financing Accounts	2006 Budgetary	2006 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	\$ 291	\$ 400	\$ 223	\$ 520
Recoveries of Prior Year Unpaid Obligations	43	90	41	125
Budget Authority				
Appropriation	889	0	901	0
Borrowing Authority (Notes 16 & 17)	0	2,135	0	1,462
Spending Authority from Offsetting Collections:				
Earned				
Collected	251	1,131	271	977
Change in Receivables from Federal Sources	0	0	0	0
Change in Unfilled Customer Orders				
Without Advance from Federal Sources	0	32	2	10
Nonexpenditure Transfers, Net, Anticipated & Actual	(5)	0	0	0
Permanently Not Available	(342)	(1,197)	(262)	(567)
Total Budgetary Resources	\$ 1,127	\$ 2,591	\$ 1,156	\$ 2,527
Status of Budgetary Resources:				
Obligations Incurred: (Note 15)				
Direct	\$ 926	2,235	\$ 865	\$ 2,127
Reimbursable	0	0	0	0
Unobligated Balance:				
Apportioned	170	128	167	156
Unobligated Balance Not Available				
	31	228	124	244
Total Status of Budgetary Resources	\$ 1,127	\$ 2,591	\$ 1,156	\$ 2,527
Change in Obligated Balance:				
Obligated Balance, Net				
Unpaid Obligations Brought Forward, Oct. 1	\$ 2,514	\$ 4,149	\$ 2,610	\$ 3,943
Uncollected Customer Payments from Federal Sources, Brought Forward, Oct. 1	(2)	(265)	0	(254)
Total Unpaid Obligated Balance, Net	2,512	3,884	2,610	3,689
Obligations Incurred, Net				
Gross Outlays	926	2,235	865	2,127
Recoveries of Prior Year Unpaid Obligations	(922)	(2,205)	(920)	(1,797)
Change in Uncollected Customer Payments from Federal Sources	(43)	(90)	(41)	(125)
	0	(32)	(2)	(10)
Obligated Balance, Net, End of Period:				
Unpaid Obligations (Note 21)	2,475	4,089	2,514	4,149
Uncollected Customer Payments from Federal Sources	(2)	(297)	(2)	(265)
Total Unpaid Obligated Balance, Net, End of Period	\$ 2,473	\$ 3,792	\$ 2,512	\$ 3,884
Net Outlays				
Gross Outlays	\$ 922	2,205	\$ 920	\$ 1,797
Offsetting Collections	(251)	(1,131)	(271)	(977)
Distributed Offsetting Receipts	(146)	0	(118)	0
Total Net Outlays	\$ 525	1,074	\$ 531	\$ 820

REQUIRED SUPPLEMENTARY INFORMATION

Amounts are presented in millions

	2007 Budgetary	2007 Non-Budgetary Credit Program Financing Accounts	2006 Budgetary	2006 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	\$ 1,106	\$ 229	\$ 2,313	\$ 274
Recoveries of Prior Year Unpaid Obligations	29	679	14	358
Budget Authority				
Appropriation	153	0	86	0
Borrowing Authority (Notes 16 & 17)	0	6,342	0	6,703
Spending Authority from Offsetting Collections:				
Earned				
Collected	2,917	2,884	1,276	1,725
Change in Receivables from Federal Sources	0	0	0	0
Change in Unfilled Customer Orders				
Without Advance from Federal Sources	0	(10)	0	(2)
Nonexpenditure Transfers, Net, Anticipated & Actual	0	0	65	0
Permanently Not Available	(2,476)	(2,576)	(1,925)	(1,382)
Total Budgetary Resources	\$ 1,729	\$ 7,448	\$ 1,829	\$ 7,576
Status of Budgetary Resources:				
Obligations Incurred: (Note 15)				
Direct	\$ 1,063	\$ 7,306	\$ 723	\$ 7,447
Reimbursable	0	0	0	0
Unobligated Balance:				
Apportioned	79	142	7	229
Unobligated Balance Not Available	587	0	1,099	0
Total Status of Budgetary Resources	\$ 1,729	\$ 7,448	\$ 1,829	\$ 7,576
Change in Obligated Balance:				
Obligated Balance, Net				
Unpaid Obligations Brought Forward, Oct. 1	\$ 198	\$ 12,176	\$ 236	\$ 11,629
Uncollected Customer Payments from Federal Sources, Brought Forward, Oct. 1	0	(40)	0	(43)
Total Unpaid Obligated Balance, Net	198	12,136	236	11,586
Obligations Incurred, Net	1,063	7,306	723	7,447
Gross Outlays	(1,013)	(7,010)	(747)	(6,541)
Recoveries of Prior Year Unpaid Obligations	(29)	(679)	(14)	(358)
Change in Uncollected Customer Payments from Federal Sources	0	10	0	2
Obligated Balance, Net, End of Period:				
Unpaid Obligations (Note 21)	219	11,794	198	12,176
Uncollected Customer Payments from Federal Sources	0	(31)	0	(40)
Total Unpaid Obligated Balance, Net, End of Period	\$ 219	\$ 11,763	\$ 198	\$ 12,136
Net Outlays				
Gross Outlays	\$ 1,013	\$ 7,010	\$ 747	\$ 6,541
Offsetting Collections	(2,917)	(2,884)	(1,276)	(1,725)
Distributed Offsetting Receipts	(239)	0	(344)	0
Total Net Outlays	\$ (2,143)	\$ 4,126	\$ (873)	\$ 4,816

REQUIRED SUPPLEMENTARY INFORMATION

Amounts are presented in millions

	2007 Budgetary	2007 Non-Budgetary Credit Program Financing Accounts	2006 Budgetary	2006 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	\$ 41	\$ 3	\$ 1,472	\$ 82
Recoveries of Prior Year Unpaid Obligations	2	133	33	258
Budget Authority				
Appropriation	0	0	3	0
Borrowing Authority (Notes 16 & 17)	0	116	0	27
Spending Authority from Offsetting Collections:				
Earned				
Collected	0	80	46	71
Change in Receivables from Federal Sources	0	0	(6)	0
Change in Unfilled Customer Orders				
Without Advance from Federal Sources	0	(3)	0	(3)
Nonexpenditure Transfers, Net, Anticipated & Actual	0	0	(65)	0
Permanently Not Available	(3)	(212)	(4)	(380)
Total Budgetary Resources	\$ 40	\$ 117	\$ 1,479	\$ 55
Status of Budgetary Resources:				
Obligations Incurred: (Note 15)				
Direct	\$ 0	\$ 117	\$ 1,438	\$ 52
Reimbursable	0	0	0	0
Unobligated Balance:				
Apportioned	0	0	0	3
Unobligated Balance Not Available	40	0	41	0
Total Status of Budgetary Resources	\$ 40	\$ 117	\$ 1,479	\$ 55
Change in Obligated Balance:				
Obligated Balance, Net				
Unpaid Obligations Brought Forward, Oct. 1	\$ 13	\$ 910	\$ 96	\$ 1,235
Uncollected Customer Payments from Federal Sources, Brought Forward, Oct. 1	0	(15)	(6)	(18)
Total Unpaid Obligated Balance, Net	13	895	90	1,217
Obligations Incurred, Net	0	117	1,438	52
Gross Outlays	0	(171)	(1,488)	(119)
Recoveries of Prior Year Unpaid Obligations	(2)	(133)	(33)	(258)
Change in Uncollected Customer Payments from Federal Sources	0	3	6	3
Obligated Balance, Net, End of Period:				
Unpaid Obligations (Note 21)	11	723	13	910
Uncollected Customer Payments from Federal Sources	0	(12)	0	(15)
Total Unpaid Obligated Balance, Net, End of Period	\$ 11	\$ 711	\$ 13	\$ 895
Net Outlays				
Gross Outlays	\$ 0	\$ 171	\$ 1,488	\$ 119
Offsetting Collections	0	(80)	(46)	(71)
Distributed Offsetting Receipts	(88)	0	(28)	0
Total Net Outlays	\$ (88)	\$ 91	\$ 1,414	\$ 48

REQUIRED SUPPLEMENTARY INFORMATION

Amounts are presented in millions

	2007 Budgetary	2007 Non-Budgetary Credit Program Financing Accounts	2006 Budgetary	2006 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	\$ 148	\$ 670	\$ 141	\$ 1,100
Recoveries of Prior Year Unpaid Obligations	25	78	70	95
Budget Authority				
Appropriation	685	0	1,168	0
Borrowing Authority (Notes 16 & 17)	0	1,834	0	1,411
Spending Authority from Offsetting Collections:				
Earned				
Collected	1,025	1,749	1,203	2,338
Change in Receivables from Federal Sources	0	0	0	0
Change in Unfilled Customer Orders				
Without Advance from Federal Sources	0	(12)	0	(8)
Nonexpenditure Transfers, Net, Anticipated & Actual	(9)	0	0	0
Permanently Not Available	(1,074)	(1,354)	(1,266)	(1,834)
Total Budgetary Resources	\$ 800	\$ 2,965	\$ 1,316	\$ 3,102
Status of Budgetary Resources:				
Obligations Incurred: (Note 15)				
Direct	\$ 733	\$ 2,218	\$ 1,168	\$ 2,432
Reimbursable	0	0	0	0
Unobligated Balance:				
Apportioned	33	166	48	125
Unobligated Balance Not Available	34	581	100	545
Total Status of Budgetary Resources	\$ 800	\$ 2,965	\$ 1,316	\$ 3,102
Change in Obligated Balance:				
Obligated Balance, Net				
Unpaid Obligations Brought Forward, Oct. 1	\$ 206	\$ 765	\$ 242	\$ 808
Uncollected Customer Payments from Federal Sources, Brought Forward, Oct. 1	0	(231)	0	(238)
Total Unpaid Obligated Balance, Net	206	534	242	570
Obligations Incurred, Net	733	2,218	1,168	2,432
Gross Outlays	(710)	(2,179)	(1,134)	(2,381)
Recoveries of Prior Year Unpaid Obligations	(25)	(78)	(70)	(95)
Change in Uncollected Customer Payments from Federal Sources	0	12	0	8
Obligated Balance, Net, End of Period:				
Unpaid Obligations (Note 21)	204	726	206	765
Uncollected Customer Payments from Federal Sources	0	(219)	0	(231)
Total Unpaid Obligated Balance, Net, End of Period	\$ 204	\$ 507	\$ 206	\$ 534
Net Outlays				
Gross Outlays	\$ 710	\$ 2,179	\$ 1,134	\$ 2,381
Offsetting Collections	(1,025)	(1,749)	(1,203)	(2,338)
Distributed Offsetting Receipts	0	0	(188)	0
Total Net Outlays	\$ (315)	\$ 430	\$ (257)	\$ 43

REQUIRED SUPPLEMENTARY INFORMATION

Amounts are presented in millions

	2007 Budgetary	2007 Non-Budgetary Credit Program Financing Accounts	2006 Budgetary	2006 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	\$ 15	\$ 0	\$ 1	\$ 0
Recoveries of Prior Year Unpaid Obligations	1	0	1	0
Budget Authority				
Appropriation	680	0	730	0
Borrowing Authority (Notes 16 & 17)	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	(2)	0	0	0
Permanently Not Available	(58)	0	(68)	0
Total Budgetary Resources	\$ 646	\$ 0	\$ 664	\$ 0
Status of Budgetary Resources:				
Obligations Incurred: (Note 15)				
Direct	\$ 620	\$ 0	\$ 649	\$ 0
Reimbursable	0	0	0	0
Unobligated Balance:				
Apportioned	25	0	9	0
Unobligated Balance Not Available				
	1	0	6	0
Total Status of Budgetary Resources	\$ 646	\$ 0	\$ 664	\$ 0
Change in Obligated Balance:				
Obligated Balance, Net				
Unpaid Obligations Brought Forward, Oct. 1	\$ 2,157	\$ 0	\$ 2,365	\$ 0
Uncollected Customer Payments from Federal Sources, Brought Forward, Oct. 1	0	0	0	0
Total Unpaid Obligated Balance, Net	2,157	0	2,365	0
Obligations Incurred, Net	620	0	649	0
Gross Outlays	(889)	0	(856)	0
Recoveries of Prior Year Unpaid Obligations	(1)	0	(1)	0
Change in Uncollected Customer Payments from Federal Sources	0	0	0	0
Obligated Balance, Net, End of Period:				
Unpaid Obligations (Note 21)	1,887	0	2,157	0
Uncollected Customer Payments from Federal Sources	0	0	0	0
Total Unpaid Obligated Balance, Net, End of Period	\$ 1,887	\$ 0	\$ 2,157	\$ 0
Net Outlays				
Gross Outlays	\$ 889	\$ 0	\$ 856	\$ 0
Offsetting Collections	0	0	0	0
Distributed Offsetting Receipts	0	0	0	0
Total Net Outlays	\$ 889	\$ 0	\$ 856	\$ 0

REQUIRED SUPPLEMENTARY INFORMATION

Amounts are presented in millions

	2007 Budgetary	2007 Non-Budgetary Credit Program Financing Accounts	2006 Budgetary	2006 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	\$ 24	\$ 0	\$ 16	\$ 0
Recoveries of Prior Year Unpaid Obligations	15	3	10	0
Budget Authority				
Appropriation	128	0	129	0
Borrowing Authority (Notes 16 & 17)	0	55	0	46
Spending Authority from Offsetting Collections:				
Earned				
Collected	0	9	0	0
Change in Receivables from Federal Sources	0	0	0	0
Change in Unfilled Customer Orders				
Without Advance from Federal Sources	0	6	0	14
Nonexpenditure Transfers, Net, Anticipated & Actual	8	0	0	0
Permanently Not Available	0	(5)	(1)	(2)
Total Budgetary Resources	\$ 175	\$ 68	\$ 154	\$ 58
Status of Budgetary Resources:				
Obligations Incurred: (Note 15)				
Direct	\$ 119	\$ 68	\$ 130	\$ 58
Reimbursable	0	0	0	0
Unobligated Balance:				
Apportioned	53	0	23	(1)
Unobligated Balance Not Available	3	0	1	1
Total Status of Budgetary Resources	\$ 175	\$ 68	\$ 154	\$ 58
Change in Obligated Balance:				
Obligated Balance, Net				
Unpaid Obligations Brought Forward, Oct. 1	\$ 234	\$ 64	\$ 222	\$ 6
Uncollected Customer Payments from Federal Sources, Brought Forward, Oct. 1	0	(17)	0	(3)
Total Unpaid Obligated Balance, Net	234	47	222	3
Obligations Incurred, Net	119	68	130	58
Gross Outlays	(113)	(17)	(108)	0
Recoveries of Prior Year Unpaid Obligations	(15)	(3)	(10)	0
Change in Uncollected Customer Payments from Federal Sources	0	(6)	0	(14)
Obligated Balance, Net, End of Period:				
Unpaid Obligations (Note 21)	225	112	234	64
Uncollected Customer Payments from Federal Sources	0	(23)	0	(17)
Total Unpaid Obligated Balance, Net, End of Period	\$ 225	\$ 89	\$ 234	\$ 47
Net Outlays				
Gross Outlays	\$ 113	\$ 17	\$ 108	\$ 0
Offsetting Collections	0	(9)	0	0
Distributed Offsetting Receipts	0	0	0	0
Total Net Outlays	\$ 113	\$ 8	\$ 108	\$ 0

REQUIRED SUPPLEMENTARY INFORMATION

Amounts are presented in millions

	2007 Budgetary	2007 Non-Budgetary Credit Program Financing Accounts	2006 Budgetary	2006 Non-Budgetary Credit Program Financing Accounts
	Salaries & Expense	Salaries & Expense	Salaries & Expense	Salaries & Expense
Budgetary Resources:				
Unobligated Balance brought forward, Oct. 1	\$ 40	\$ 0	\$ 24	\$ 0
Recoveries of Prior Year Unpaid Obligations	32	0	124	0
Budget Authority				
Appropriation	162	0	166	0
Borrowing Authority (Notes 16 & 17)	0	0	0	0
Spending Authority from Offsetting Collections:				
Earned				
Collected	512	0	514	0
Change in Receivables from Federal Sources	0	0	(1)	0
Change in Unfilled Customer Orders				
Without Advance from Federal Sources	0	0	0	0
Nonexpenditure Transfers, Net, Anticipated & Actual	8	0	0	0
Permanently Not Available	(15)	0	(8)	0
Total Budgetary Resources	\$ 739	\$ 0	\$ 819	\$ 0
Status of Budgetary Resources:				
Obligations Incurred: (Note 15)				
Direct				
Reimbursable	517	0	523	0
Unobligated Balance:				
Apportioned	5	0	9	0
Unobligated Balance Not Available	29	0	31	0
Total Status of Budgetary Resources	\$ 739	\$ 0	\$ 819	\$ 0
Change in Obligated Balance:				
Obligated Balance, Net				
Unpaid Obligations Brought Forward, Oct. 1	\$ 119	\$ 0	\$ 134	\$ 0
Uncollected Customer Payments from Federal Sources, Brought Forward, Oct. 1	(1)	0	(2)	0
Total Unpaid Obligated Balance, Net	118	0	132	0
Obligations Incurred, Net	705	0	779	0
Gross Outlays	(667)	0	(670)	0
Recoveries of Prior Year Unpaid Obligations	(32)	0	(124)	0
Change in Uncollected Customer Payments from Federal Sources	0	0	1	0
Obligated Balance, Net, End of Period:				
Unpaid Obligations (Note 21)	125	0	119	0
Uncollected Customer Payments from Federal Sources	(1)	0	(1)	0
Total Unpaid Obligated Balance, Net, End of Period	\$ 124	\$ 0	\$ 118	\$ 0
Net Outlays				
Gross Outlays	\$ 667	\$ 0	\$ 670	\$ 0
Offsetting Collections	(512)	0	(514)	0
Distributed Offsetting Receipts	(2)	0	0	0
Total Net Outlays	\$ 153	\$ 0	\$ 156	\$ 0

REQUIRED SUPPLEMENTARY INFORMATION

Amounts are presented in millions

	2007 Budgetary	2007 Non-Budgetary Credit Program Financing Accounts	2006 Budgetary	2006 Non-Budgetary Credit Program Financing Accounts
	Other	Other	Other	Other
Budgetary Resources:				
Unobligated Balance brought forward, Oct. 1	\$ 153	\$ 3	\$ 304	\$ 8
Recoveries of Prior Year Unpaid Obligations	22	363	11	23
Budget Authority				
Appropriation	115	0	115	0
Borrowing Authority (Notes 16 & 17)	0	364	0	389
Spending Authority from Offsetting Collections:				
Earned				
Collected	92	130	100	97
Change in Receivables from Federal Sources	(44)	0	(20)	0
Change in Unfilled Customer Orders				
Without Advance from Federal Sources	0	(6)	0	(1)
Nonexpenditure Transfers, Net, Anticipated & Actual	14	0	37	0
Permanently Not Available	(118)	(458)	(196)	(83)
Total Budgetary Resources	\$ 234	\$ 396	\$ 351	\$ 433
Status of Budgetary Resources:				
Obligations Incurred: (Note 15)				
Direct	\$ 141	\$ 394	\$ 198	\$ 430
Reimbursable	0	0	0	0
Unobligated Balance:				
Apportioned	62	2	(19)	3
Unobligated Balance Not Available	31	0	172	0
Total Status of Budgetary Resources	\$ 234	\$ 396	\$ 351	\$ 433
Change in Obligated Balance:				
Obligated Balance, Net				
Unpaid Obligations Brought Forward, Oct. 1	\$ 283	\$ 1,107	\$ 214	\$ 875
Uncollected Customer Payments from Federal Sources, Brought Forward, Oct. 1	(70)	(66)	(89)	(68)
Total Unpaid Obligated Balance, Net	213	1,041	125	807
Obligations Incurred, Net	141	394	198	430
Gross Outlays	(138)	(212)	(118)	(174)
Recoveries of Prior Year Unpaid Obligations	(22)	(363)	(11)	(23)
Change in Uncollected Customer Payments from Federal Sources	44	6	20	1
Obligated Balance, Net, End of Period:				
Unpaid Obligations (Note 21)	264	925	284	1,107
Uncollected Customer Payments from Federal Sources	(26)	(59)	(70)	(66)
Total Unpaid Obligated Balance, Net, End of Period	\$ 238	\$ 866	\$ 214	\$ 1,041
Net Outlays				
Gross Outlays	\$ 138	\$ 212	\$ 118	\$ 174
Offsetting Collections	(92)	(130)	(100)	(97)
Distributed Offsetting Receipts	(13)	0	(10)	0
Total Net Outlays	\$ 33	\$ 82	\$ 8	\$ 77

REQUIRED SUPPLEMENTARY INFORMATION

Amounts are presented in millions

	2007	2007 Non-Budgetary	2006	2006 Non-Budgetary
	Budgetary	Credit Program Financing Accounts	Budgetary	Credit Program Financing Accounts
	Total	Total	Total	Total
Budgetary Resources:				
Unobligated Balance brought forward, Oct. 1	\$ 1,818	\$ 1,305	\$ 4,494	\$ 1,984
Recoveries of Prior Year Unpaid Obligations	169	1,346	304	859
Budget Authority				
Appropriation	2,822	0	3,298	0
Borrowing Authority (Notes 16 & 17)	0	10,846	0	10,038
Spending Authority from Offsetting Collections:				
Earned	0	0		
Collected	4,797	5,983	3,410	5,208
Change in Receivables from Federal Sources	(44)	0	(27)	0
Change in Unfilled Customer Orders	0	0		
Without Advance from Federal Sources	0	7	2	10
Nonexpenditure Transfers, Net, Anticipated & Actual	14	0	37	0
Permanently Not Available	(4,006)	(5,902)	(3,750)	(4,248)
Total Budgetary Resources	\$ 5,490	\$ 13,585	\$ 7,768	\$ 13,851
Status of Budgetary Resources:				
Obligations Incurred: (Note 15)				
Direct	\$ 3,790	\$ 12,338	\$ 5,427	\$ 12,546
Reimbursable	517	0	523	0
Unobligated Balance:				
Apportioned	427	438	244	515
Unobligated Balance Not Available	756	809	1,574	790
Total Status of Budgetary Resources	\$ 5,490	\$ 13,585	\$ 7,768	\$ 13,851
Change in Obligated Balance:				
Obligated Balance, Net				
Unpaid Obligations Brought Forward, Oct. 1	\$ 5,724	\$ 19,171	\$ 6,119	\$ 18,496
Uncollected Customer Payments from Federal Sources, Brought Forward, Oct. 1	(73)	(634)	(97)	(624)
Total Unpaid Obligated Balance, Net	5,651	18,537	6,022	17,872
Obligations Incurred, Net	4,307	12,338	5,950	12,546
Gross Outlays	(4,452)	(11,794)	(6,041)	(11,012)
Recoveries of Prior Year Unpaid Obligations	(169)	(1,346)	(304)	(859)
Change in Uncollected Customer Payments from Federal Sources	44	(7)	25	(10)
Obligated Balance, Net, End of Period:				
Unpaid Obligations (Note 21)	5,410	18,369	5,725	19,171
Uncollected Customer Payments from Federal Sources	(29)	(641)	(73)	(634)
Total Unpaid Obligated Balance, Net, End of Period	\$ 5,381	\$ 17,728	\$ 5,652	\$ 18,537
Net Outlays				
Gross Outlays	\$ 4,452	\$ 11,794	\$ 6,041	\$ 11,012
Offsetting Collections	(4,797)	(5,983)	(3,410)	(5,208)
Distributed Offsetting Receipts	(488)	0	(688)	0
Total Net Outlays	\$ (833)	\$ 5,811	\$ 1,943	\$ 5,804