UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250

DATE: February 11, 2000

REPLY TO
ATTN OF: 09016-1-Te

SUBJECT: Telephone Loan Program Policies and Procedures

TO: Wally B. Beyer
Administrator
Rural Utilities Service

ATTN: Sherie Hinton Henry
Director
Financial Management Division

This report presents the results of our audit of Rural Utilities Service's (RUS) telephone loan program policies and procedures. RUS' written response to the draft report is included as exhibit F, and RUS' comments and the Office of Inspector General (OIG) position concerning the written response are set forth in the Recommendations sections of the report.

We do not agree with RUS' management decisions for Recommendations Nos. 1, 2, 3, and 4. Additional information is needed to reach agreement on the management decisions for these recommendations. The information needed to reach agreement is set forth in the Recommendations sections of the report.

Please furnish the information needed to reach agreement on the management decisions for Recommendations Nos. 1, 2, 3, and 4 by March 31, 2000. Please note that Departmental Regulation 1720-1 requires a management decision for all recommendations within a maximum of 6 months from the date of report issuance. Follow your internal agency procedures in forwarding final action correspondence to the Office of the Chief Financial Officer.

We appreciate the cooperation and courtesies provided during the evaluation. If you have any questions, please have a member of your staff contact Rebecca A. Batts, Director, Rural Development and Natural Resources Division, at 720-6805.

JAMES R. EBBITT
Assistant Inspector General
for Audit

RURAL UTILITIES SERVICE
TELEPHONE LOAN PROGRAM
POLICIES AND PROCEDURES
WASHINGTON, D.C.
AUDIT REPORT NO. 09016-1-Te

FEBRUARY 2000

UNITED STATES DEPARTMENT OF AGRICULTURE
OFFICE OF INSPECTOR GENERAL - AUDIT
SOUTHWEST REGION
ROOM 324, FEDERAL OFFICE BUILDING
101 SOUTH MAIN STREET
TEMPLE, TEXAS 76501

EXECUTIVE SUMMARY

RURAL UTILITIES SERVICE TELEPHONE LOAN PROGRAM POLICIES AND PROCEDURES WASHINGTON, D.C. AUDIT NO. 09016-1-Te

RESULTS IN BRIEF

This report presents the results of our review of the Rural Utilities Service's (RUS) Telephone Loan Program. We initiated this review to determine whether RUS continues to make and service loans to telephone company borrowers who could obtain financing from other credit sources. In January 1998, the U.S. General Accounting Office (GAO) reported some options that Congress could consider to make the telephone loan program more effective and less costly. The GAO found that RUS made loans to financially healthy borrowers that may not need Federal assistance and that the implementation of loan graduation procedures could assist in moving such borrowers to commercial credit sources.

GAO found that many telephone borrowers had favorable financial characteristics. Specifically, about 24 percent of the borrowers had net worth (total assets less total liabilities) of $10 million or more at the end of the year prior to receiving RUS loans, and another 65 percent had net worth between $1 million and $10 million. In addition, about 29 percent of the borrowers had net income of $1 million or more in the year prior to receiving the loans, and another 61 percent had net income between $100,000 and $1 million. Furthermore, about 80 percent of the borrowers had a current ratio (a measure of the extent to which a borrower has sufficient current assets to cover its current liabilities) of 2 or more times; 83 percent had a debt-to-asset ratio (the extent to which a borrower has sufficient assets to cover all of its debt) of 70 percent or less; and 87 percent had a times-interest-earned ratio (TIER; the extent to which a borrower can pay its annual interest expenses from its net income) of 2 or more.

GAO also found that because graduation is not an integral part of RUS's operation, some borrowers may have direct loans longer than needed and are therefore able to take advantage of the favorable terms that exist with such programs. GAO reported that RUS continues to incur interest and other administrative expenses in servicing the accounts of financially healthy borrowers. GAO reported that many borrowers with outstanding direct loans as of December 31, 1996, had favorable financial characteristics indicating that they may be viable candidates for having the commercial sector refinance their RUS debt.

Our review found that little has changed since the GAO review. We found that although Congressional policy for making and servicing telephone program loans have led to the substantial improvement in the financial condition of borrowers, the policy has not resulted in moving financially strong borrowers to non-Government credit sources. We found that RUS continues to make and service loans to financially strong borrowers who likely could obtain financing from other sources. RUS has not established procedures and requirements for financially strong borrowers to seek credit from other sources nor has it established a loan graduation program for borrowers who no longer need Government assistance because the RE Act does not require such procedures.

Congressional policy requires RUS to assist borrowers to achieve financial strength to enable them to satisfy their credit needs from their own financial organizations and other sources. However, loan eligibility criteria is not based on financial need and Congress expects RUS to use all available loan funds. Also, RUS' annual appropriation budget is based on anticipated loan requests from all applicants regardless of financial condition. As a result, RUS makes loans to telephone companies regardless of financial strength.

Our trend analysis of key financial ratios for the 17-year period 1981 through 1997 revealed that many RUS borrowers are financially strong, able to pay higher interest rates, and do not need Government assistance. For example, during this 17-year period, the composite equity ratio (net worth as a percent of total assets) of all borrowers nearly doubled from 25.3 percent to 50.3 percent, the debt-to-asset ratio decreased one-third from 74.7 percent to 49.7 percent, the long-term debt to equity ratio decreased over two-thirds from 234.8 percent to 70.5 percent, and the TIER more than doubled from 2.25 to 4.65.

We found that over half the telephone borrowers had sufficient financial strength to repay their loans and/or could obtain or be graduated to non-Government lending sources. Of $4.8 billion in loans to 815 RUS direct and guaranteed telephone borrowers as of December 31, 1997, we determined that 434 borrowers (53 percent) with loans totaling $1.87 billion (39 percent) were in as good or better financial condition as 16 telephone borrowers who paid in full (PIF) their RUS loans during 1998. These 16 borrowers paid off RUS loans totaling over $125 million an average 22.6 years ahead of schedule. These 434 borrowers had equity ratios, long-term debt to equity ratios, and TIER's that were equal to or better than the average of these financial ratios for the 16 PIF borrowers.

For example, the equity ratio is a measure of net worth as a percent of total assets. Creditors prefer high equity ratios. The composite equity ratio for all 815 borrowers was 50.3 percent. The average equity ratio for the PIF borrowers was 44.5 percent whereas the average ratio for the 434 borrowers determined to be in strong financial condition was 65 percent. One commercial lender who provided loan funds to rural utility companies stated that it required a minimum equity ratio of 20 percent to make a long-term loan to a telephone company. The average equity ratio for the 434 borrowers in strong financial condition was over three times the minimum required by the commercial lender.

Another measure of financial strength is the long-term debt to equity ratio which focuses on how much long-term creditors have invested in the company compared to the owners. The lower the ratio the more financially secure the borrower. The composite long-term debt to equity ratio for all 815 borrowers was 70.5 percent. The average ratio for the PIF borrowers was 111.1 percent while the average ratio for the 434 borrowers in strong financial condition was 40 percent.

Still another measurement of financial strength is the TIER which indicates the ability of a borrower to cover its interest obligations through annual earnings. All other factors being equal, the larger the ratio the better the credit risk. By statute, a direct telephone borrower must have a TIER of at least 1 with a 1.5 TIER needed to qualify for a guaranteed loan. The composite TIER for all 815 borrowers was 4.65. The average TIER for the PIF borrowers was 3.98 and the average TIER for the 434 borrowers identified as being in strong financial condition was 6.27. A major commercial lender to rural utility companies stated that it required a TIER of at least 1.5 to make a long-term loan. The average TIER for the 434 borrowers in strong financial condition was over four times the minimum required by the commercial lender.

In addition, RUS had not deobligated unused loan funds. There were no administrative procedures to determine when loan purposes had been accomplished, thereby allowing for the deobligation of unused funds. We identified 409 loans that were made more than 5 years before January 1, 1999, with unused balances totalling almost $602.3 million that had not been reviewed for deobligation.

See exhibit A for a summary of monetary results.

KEY RECOMMENDATIONS

We recommend that RUS work with Congress to clarify RUS policy for the telephone loan program regarding loan graduation and requiring financially strong borrowers to obtain credit from non-Government sources. If Congress determines that RUS should require financially strong borrowers to obtain credit from other sources and graduate financially strong borrowers to non-Government credit sources, we recommend that RUS develop a strategy to require borrowers to have been denied commercial credit as a condition for RUS financial assistance and establish a graduation program to assist financially strong borrowers to refinance their outstanding direct loans to other credit sources. In addition, we recommend that RUS implement procedures to annually evaluate telephone loans and deobligate all unused funds for those loans in which the purposes of the loans have been accomplished.

AGENCY RESPONSE

In his written response to the draft report, the RUS Acting Administrator stated that rather than improving efficiencies, the audit recommendations are in conflict with the clear intent of Congress that rural telecommunications subscribers be afforded the same economic, educational, and health care opportunities as urban and suburban residents. The Acting Administrator stated that RUS is more than a lender, and that participation in the RUS program brings with it requirements for enhanced telecommunications standards and capacity.

The Acting Administrator said a mandatory loan graduation process would not only hold rural subscribers hostage to inferior telecommunications service, it could result in many rural Americans becoming the economic "have-nots" of the 21st century. He stated that such a result is contrary to the clear policies established by Congress in the Rural Electrification [Loan] Restructuring Act (RELRA) of 1993 and the Telecommunications Act of 1996 as well as RUS' annual appropriations language. The Acting Administrator did not agree to take action on the audit recommendations. The Acting Administrator's complete response is included in exhibit F.

OIG POSITION

We agree that it is the intent of Congress that rural areas are to be provided the same economic, educational, and health care opportunities as urban and suburban residents. We also agree that RUS is more than a lender; nevertheless, the primary function of the RUS telephone loan program is to provide financial assistance to telephone company borrowers who service rural areas. That being the case, RUS must meet the requirements of law established by Congress for Government loan programs, which currently requires RUS to encourage and assist rural telephone systems to develop their resources and ability to achieve the financial strength needed to enable them to satisfy their credit needs from their own financial organizations and other sources.

RUS has done an excellent job of assisting telephone borrowers achieve the financial strength to satisfy their credit needs from their own financial organizations and/or other sources. However, RUS has done very little to encourage and assist financially strong borrowers to satisfy their credit needs from their own financial organizations and/or other sources. We identified over 400 telephone borrowers with RUS loans totaling over $1.8 billion who were in strong financial condition and likely could satisfy their credit needs without RUS assistance.

We disagree that a loan graduation process would hold rural subscribers hostage to inferior telecommunications service and result in many rural Americans becoming the economic "have-nots" of the 21st century. A loan graduation program would only affect those borrowers who achieve a strong financial position and, therefore, are able to satisfy their credit needs from their own financial organizations and/or refinance their RUS loans through other credit sources. A graduation program would not affect loan applications from borrowers who need RUS financial assistance.

We continue to believe that RUS should apprise Congress of the strong financial condition of telephone company borrowers and to work with Congress to determine whether it continues to be Congressional intent and policy that financially strong borrowers are to be encouraged and assisted to obtain financing from their own financial organizations and/or other credit sources. If it is still Congressional intent that RUS is to encourage and assist financially strong borrowers to meet their credit needs from other sources, RUS needs to initiate immediate action to implement this policy.

We request that RUS reconsider its management decisions for the audit recommendations and develop a strategy to work with Congress to clarify policy for loan graduation programs and requiring financially strong borrowers to obtain credit from other sources. OIG's complete position regarding the Acting Administrator's response and the information needed to reach agreement on the management decisions is set forth in the Recommendations sections of the report.

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ABBREVIATIONS

CFR	-	Code of Federal Regulations
CY	-	Calendar Year
FFB	-	Federal Financing Bank
FY	-	Fiscal Year
GAO	-	General Accounting Office
OIG	-	Office of Inspector General
PIF	-	Paid in Full
RE Act	-	Rural Electrification Act
REA	-	Rural Electrification Administration
RELRA	-	Rural Electrification Loan Restructuring Act
RTB	-	Rural Telephone Bank
RUS	-	Rural Utilities Service
TIER	-	Times-Interest-Earned Ratio
USC	-	United States Code
USDA	-	United States Department of Agriculture

INTRODUCTION

BACKGROUND

The Rural Electrification Act of 1936 (RE Act) established the Rural Electrification Administration (REA) as a lending agency with responsibility for developing a program for rural electrification. In 1949, the RE Act was amended to authorize REA to make loans to improve and extend telephone service in rural areas. The Rural Telephone Bank (RTB) was established by another amendment to the RE Act in 1971. In 1973, the RE Act was further amended to establish a revolving fund and to provide authority for REA to guarantee loans made by other legally organized lenders.

The Secretary of Agriculture was required to establish RUS pursuant to section 232 of the Federal Crop Insurance Reform and Department of Agriculture Reorganization Act of 1994. That Act established RUS as the successor to REA with responsibility for administering electric and telephone loan programs.

RUS makes three types of loans: Hardship, concurrent cost-of-money, and guaranteed. Hardship loans are direct loans from RUS at 5 percent interest. Concurrent loans are a combination of RUS direct cost-of-money loans and RTB loans. The interest rate for cost-of-money loans is equal to the current cost of money to the Federal Government, but not to exceed 7 percent. The interest rates for RTB loans are established by the Governor of RTB in accordance with Title 7, Code of Federal Regulations (CFR), section 1610.10. The interest rates for RTB loans are close to the cost of money to the Federal Government.

The Secretary may fully guarantee loans through RTB, National Rural Utilities Cooperative Finance Corporation, and any other legally organized lending agency at any rate agreed to by the borrower and lender. Most telephone guaranteed loans are made by the Federal Financing Bank (FFB). Guaranteed loans are typically made at the cost of money to the Treasury plus 1/8 of 1 percent. Concurrent RUS cost-of-money and RTB loans may be made simultaneously with hardship loans or guaranteed loans.

During the 3-year period 1995 through 1997, $1.48 billion in long-term telephone loan financing was approved, including $842 million in RUS direct loans, $404 million in RTB loans, and $233 million in guaranteed loans. As of December 1997, there were 864 active telephone company borrowers of which 815 reported financial information to RUS.

OBJECTIVE

Our audit objective was to determine whether RUS continues to make and service loans to telephone company borrowers who could obtain financing from other credit sources.

SCOPE

At the RUS National Office in Washington, D.C., we obtained background information on laws and regulations governing telephone loans and reviewed policies and procedures for making and servicing loans. We reviewed the RE Act amendments and Congressional policy regarding the telephone loan program and borrowers in strong financial condition.

We reviewed statistical information and evaluated trends from 1981 through 1997, the latest date for which statistical information was available. We also determined average financial ratios for 16 borrowers who satisfied their credit needs from their own or other sources by paying off their RUS loans several years early in 1998. We compared these average ratios to the financial ratios of all 815 telephone borrowers that provided financial information to RUS for calendar year (CY) 1997 to identify RUS telephone borrowers who were in strong financial condition as of December 31, 1997. We also compared the results of our analysis with a January 1998 U.S. General Accounting Office (GAO) report which addressed RUS loans to financially healthy borrowers.

We contacted the National Rural Utilities Cooperative Finance Corporation (NRUCFC) in Herdon, Virginia, and the Farm Credit System CoBank in Englewood, Colorado, and obtained financial ratios that these commercial lenders require in order to make loans to telephone companies.

This audit was conducted in accordance with the Government Auditing Standards issued by the Comptroller General of the United States. Accordingly, the audit included such tests of program and accounting records as considered necessary to meet the audit objectives.

METHODOLOGY

At the RUS National Office, we reviewed laws, rules, regulations, and staff instructions governing telephone loans; interviewed responsible staff; and reviewed telephone loan applications and loan documents. In addition, we reviewed GAO reports covering telephone loans (GAO/RCED-97-82, Rural Development, Financial Condition of the Rural Utilities Service's Loan Portfolio, issued April 1997; and GAO/RCED-98-42, Rural Utilities Service, Opportunities to Operate Electricity and Telecommunications Loan Programs More Effectively, issued January 1998). We also reviewed and evaluated financial trends as shown in composite statistics of the agency's loan portfolio for the 17-year period 1981 through 1997.

We sent letters to NRUCFC and CoBank to request information regarding their financial requirements for making loans to telephone company borrowers. We used the written responses to compare their financial requirements to the borrowers we identified that were in strong financial condition.

FINDINGS AND RECOMMENDATIONS

CHAPTER 1. FINANCIALLY STRONG BORROWERS CONTINUE TO RECEIVE RUS LOANS

FINDING NO. 1

RUS loan making and servicing policies have led to the substantial improvement in the financial condition of telephone program borrowers. However, these policies have not led to making loans only to borrowers who need Federal assistance or to moving financially strong borrowers to other credit sources. The U.S. General Accounting Office (GAO) reported in January 1998 that RUS made loans to borrowers that may not need Federal assistance. During this review, we found this was still true. We identified 434 RUS telephone program borrowers with RUS loan balances totaling $1.87 billion that appear to be in good enough financial condition to satisfy their credit needs from their own financial organizations and/or other credit sources.

Title 7 United States Code (USC) 930[1] states that it is the policy of Congress that adequate funds be made available to rural telephone systems through direct, insured, and guaranteed loans at interest rates which will allow them to achieve the objectives of the RE Act of 1936. In addition, rural telephone systems are to be encouraged and assisted to develop their resources and ability to achieve the financial strength needed to enable them to satisfy their credit needs from their own financial organizations and other sources.

GAO DETERMINES TELEPHONE PROGRAM COULD BE MORE COST EFFECTIVE

In January 1998, the GAO reported to the U.S. Senate Committee on Agriculture, Nutrition, and Forestry[2] a number of options that the Congress could consider to make the RUS telephone loan program more effective and less costly. The GAO reported, in part, that loans are made to financially healthy borrowers that may not need RUS' assistance and that a graduation program could assist in moving financially healthy borrowers to commercial credit.

[1]Title 7 USC 930, Congressional Declaration of Policy, dated May 11, 1973.

[2]GAO Report No. GAO/RECD-98-42, Rural Utilities Service - Opportunities to Operate Electricity and Telecommunications Loan Programs More Effectively, issued January 1998.

Loans Made to Financially Strong Borrowers

The GAO reported that unlike the requirements for other USDA rural credit programs -- such as the water and waste disposal, farm, single-family housing, and community facilities loan programs -- the RE Act does not require loan applicants to demonstrate that they cannot obtain credit from other lenders before applying for a RUS loan. Also, the RE Act does not preclude financially healthy borrowers from receiving RUS loans. As a result, RUS' loans are sometimes made to financially healthy borrowers that may not need Federal assistance to fund their utility projects.

GAO reported that many telephone borrowers that obtained loans during calendar years CY 1994 through June 30, 1997, had favorable financial characteristics. Specifically, about 24 percent of the borrowers had equity (net worth; i.e., total assets less total liabilities) of $10 million or more at the end of the year prior to receiving the loans, and another 65 percent had equity of between $1 million and $10 million. In addition, about 29 percent of the borrowers made a profit (net income) of $1 million or more in the year prior to receiving the loans, and another 61 percent made a profit of between $100,000 and $1 million. Furthermore, about 80 percent of the borrowers had a current ratio (a measure of the extent to which a borrower has sufficient current assets to cover it current liabilities) of 2 or more times; 83 percent had a debt-to-asset ratio (the extent to which a borrower has sufficient assets to cover all of its debt) of 70 percent or less; and 87 percent had a times-interest-earned ratio (TIER; the extent to which a borrower can pay its annual interest expenses from its net income) of 2 or more.

GAO reported that RUS incurs a considerable expense in providing direct loans to financially healthy borrowers. The principle cost is associated with the interest rate subsidies (the interest costs associated with loans made at rates below the rate at which RUS borrows from the Department of the Treasury). GAO stated that RUS' estimated total subsidy costs (not including its administrative costs) on direct telephone loans made during fiscal years (FY) 1994 through 1996 totaled $29 million for hardship loans and $0.1 million for cost-of-money loans.

Loan Graduation Procedure Needed

The GAO reported that the RE Act does not require RUS to attempt to move financially healthy borrowers to commercial credit sources. Under a graduation procedure, a borrower or RUS could submit financial information to other lenders to see if they would refinance the borrower's outstanding direct loans. RUS had not instituted a graduation procedure because the RE Act is silent on this issue.

GAO reported that because graduation is not an integral part of RUS's operation, some borrowers may have direct loans longer than needed and are therefore able to take advantage of the favorable terms that exist with such programs. RUS continues to incur interest and other administrative expenses in servicing the accounts of its financially healthy borrowers. GAO found that many borrowers with outstanding direct loans as of December 31, 1996, had favorable financial characteristics indicating that they may be viable candidates for having the commercial sector refinance their RUS debt.

GAO Conclusions

The GAO concluded that Congress could make the telephone loan program more effective and less costly by making financial tests a part of the eligibility criteria for direct loans and requiring borrowers to seek commercial credit as a condition for RUS assistance. GAO also concluded that to assist in moving financially healthy direct loan borrowers to the commercial sector, Congress could have RUS establish a graduation program to require borrowers to attempt to have their outstanding direct loans refinanced by commercial credit sources.

The agency disagreed with GAO's conclusions that many RUS borrowers may not need Federal assistance and that a graduation program was needed to move borrowers to commercial credit.

CONGRESSIONAL POLICY RESULTED IN IMPROVED FINANCIAL CONDITION OF TELEPHONE COMPANY BORROWERS

The fact that telephone companies have been getting financially stronger has not had the effect of moving them to commercial credit sources. The requirement to assist borrowers to achieve financial ability to satisfy their credit needs from their own organizations and/or other sources (7 USC 930) implies that this policy would apply to new loans and to graduation of existing borrowers' loans to other credit sources when Government assistance is no longer needed.

RUS officials said it was the intent of Congress that they use all of their loan funds; therefore, they make loans to telephone companies that meet established criteria (i.e., projected TIER of 1, serves a rural area, and/or had a previous RUS loan) because they have no discretion to do otherwise. RUS' annual appropriation budget is based on anticipated loan requests from all applicants regardless of financial condition. During the last three fiscal years, RUS was appropriated over $500 million per year for the telephone loan program.

RUS does not have discretion to refuse a loan because a borrower is in strong financial condition. Title 7 USC 927[3] prohibits RUS from denying a loan for any reason other than that based on a properly enacted administrative rule. There was no administrative rule for denying a loan based on a borrower's financial strength. Also, Title 7 USC 928[4] states that a loan application must be processed within 90 days.

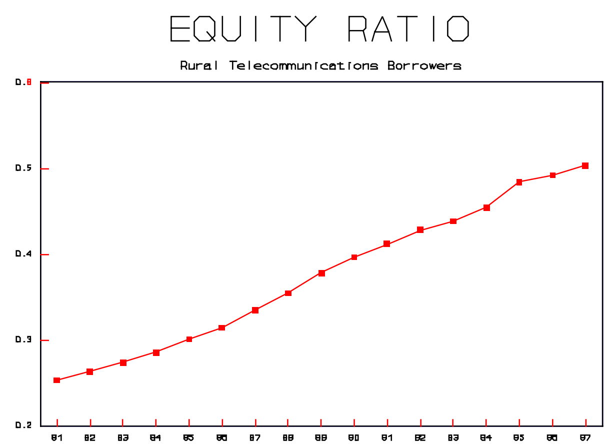
While 7 USC 930 states that telephone program borrowers are to be encouraged and assisted to achieve the financial strength to satisfy their credit needs from other sources, the RE Act is silent regarding loan graduation and RUS did not have a graduation program to move financially strong borrowers to other credit sources.

[3]Title 7 USC 927, General Duties and Prohibitions, dated October 13, 1994.

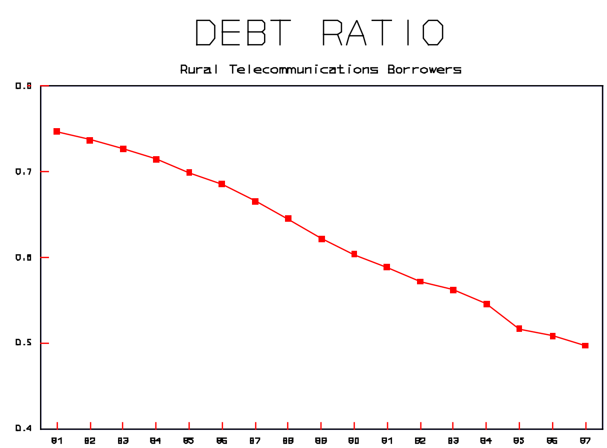
[4]Title 7 USC 928, Prompt Processing of Telephone Loans, dated October 13, 1994.

TREND ANALYSIS SHOWS STEADY IMPROVEMENT IN FINANCIAL CONDITION

We performed a trend analysis of key financial ratios on the composite RUS telephone loan portfolio for the 17-year period of calendar years 1981 through 1997. This information was taken from the annual statistical reports for rural telecommunications borrowers. There are four financial ratios that have traditionally been used to measure the solvency and stability of companies. They provide evidence of the ability of a company to meet its financial obligations. These ratios are of great interest to banks and other lenders since they indicate the level of safety or risk of a loan. The ratios are: Equity ratio (net worth as a percent of total assets), debt ratio (total liabilities as a percent of assets), debt to equity ratio (long-term debt to equity), and times-interest-earned ratio (TIER, total net income and interest divided by interest on debt).

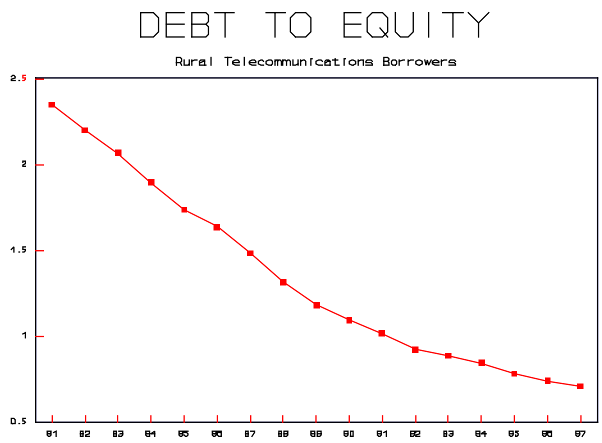


The equity ratio (also referred to as net worth as a percent of total assets) is the ratio of total owners' equity, or membership shares of a cooperative, to total assets. It shows the proportion of the total assets contributed by the owners of the entity. This ratio is of interest to lenders because in the event of business decline, their interests are better protected and there is less risk. Creditors prefer high equity ratios. During the period 1981 through 1997, the average equity ratio of all borrowers nearly doubled from 25.3 percent to 50.3 percent.

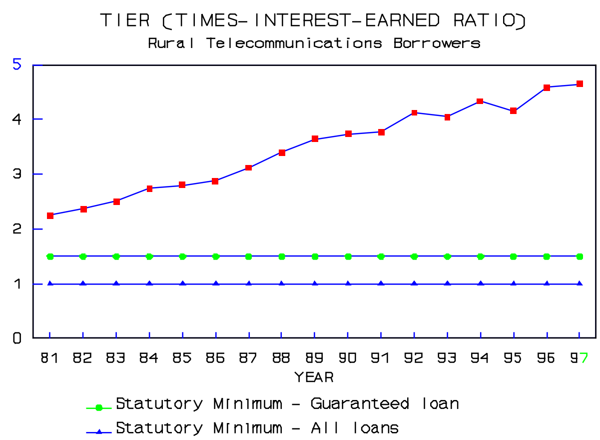


The debt ratio is the ratio of total liabilities to total assets. It shows the extent to which a borrower has sufficient assets to cover its debts and all liabilities. Creditors prefer low debt ratios because the lower the ratio, the greater the cushion against creditors' losses in the event of liquidation. The debt ratio is the mathematical complement of the equity ratio (i.e., debt ratio plus equity ratio = 100 percent). During the period 1981 through 1997, the average debt ratio of all borrowers decreased one-third from 74.7 percent to 49.7 percent.

The debt to equity ratio is used to compare long-term debt to shareholder's equity, or net worth. It focuses on how much the long-term creditors have invested in the company as compared to the owners. The lower the ratio the more financially secure the enterprise. This occurs because the debt is senior to the equity and interest must be paid before any dividends. In the event of a liquidation, principal and interest of the debt must be paid before any cash remaining can be paid to the equity holders. During the period 1981 through 1997, the average debt to equity ratio for all borrowers decreased over two-thirds from 234.8 percent to 70.5 percent.



The TIER is sometimes called the interest coverage ratio. It is an indicator of the ability of a firm to cover its interest obligations through annual earnings. As such, it is used by creditors as a measure of the safety of a loan. The larger the ratio, the better the credit risk. By statute, a telephone borrower must have a TIER of at least 1.0 to qualify for a hardship or concurrent loan, and a TIER of 1.5 to qualify for a guaranteed loan. In 1981, the composite TIER was 2.25, which was 125 percent greater than the statutory minimum of 1.0 ((2.25-1.0)/1.0 = 125 percent). In 1997, the composite TIER was 4.65, which is 365 percent greater than the statutory minimum ((4.65-1.0)/1.0 = 365 percent). During the period 1981 through 1997, the average TIER for all borrowers more than doubled from 2.25 to 4.65.



These 17-year trends show that many RUS borrowers are financially strong, able to pay higher interest rates, and do not need Government assistance.

HALF OF RUS BORROWERS IN STRONG FINANCIAL CONDITION

To identify telephone loan program borrowers who were in strong financial condition (i.e., borrowers who could reasonably be expected to obtain financing from their own and/or other non-Government sources), we evaluated key financial ratios of borrowers who paid off their RUS loans in 1998. The ratios reviewed were net worth to total assets (equity ratio), total liabilities to total assets (debt ratio), long-term debt to equity, and TIER. We obtained a list of the borrowers who paid off their telephone loans several years early in 1998 and determined average financial ratios for these borrowers that were able to satisfy their credit needs from their own or other resources.

RUS personnel identified 23 borrowers that paid off their RUS, RTB, and/or FFB loans in 1998. We determined that 19 of these 23 borrowers reported full financial information in the 1997 Statistical Report of Rural Telecommunications Borrowers (referred to hereafter as the 1997 statistical report). Of the 19 borrowers who paid in full (PIF) their RUS loans in 1998, 3 borrowers (KS 580, MN 541, and TX 637) had a TIER greater than 10 (10.3, 17.9, and 29.4, respectively). In other words, the earnings for these 3 borrowers was more than 10 times their interest expense. The TIER for these 3 borrowers was more than twice the composite TIER of 4.65 for all telephone borrowers.

Net worth to total assets for these 3 borrowers was very high (74.1, 82.1, and 76.0 percent, respectively) compared to the composite 50.3 percent for all borrowers. Long-term debt to equity was very low (23.9, 17.8, and 24.4 percent, respectively) compared to the composite 70.5 percent for all borrowers.

We concluded that these 3 borrowers were in much better financial condition than the average/typical telephone borrower. Therefore, we eliminated these 3 borrowers from the 19 borrowers who reported financial information to RUS for CY 1997 since the inclusion of their data would skew the average financial ratios for the more typical borrowers.

We analyzed the financial condition of the remaining 16 PIF borrowers and determined the average of key financial ratios that show solvency and stability of a company: Net worth as a percentage of total assets, long-term debt to equity, and TIER. These 16 PIF borrowers paid off their loans several years early. The time span between the PIF date and the date that the notes were due ranged from 7.4 years to 31.5 years, with an average of 22.6 years. The payoff amounts ranged from $241,268 to almost $63 million and averaged $7.8 million. These 16 borrowers either satisfied their credit needs from their own financial organizations and/or other lenders. The reasons these borrowers paid off the loans were not available; however, the fact that they did pay off their loans demonstrated the financial ability to pay off and/or refinance the loans. The average TIER for the 16 PIF borrowers was 3.98 and the average net worth to total assets was 44.5 percent while the average long-term debt to equity was 111.1 percent. These averages (which were less than the composite for all 815 borrowers) represent an estimate of borrowers in good financial condition. The 16 PIF borrowers and their financial ratios are summarized in exhibit B.

We then compared the average financial ratios for the 16 PIF borrowers to the universe of 815 borrowers reported in the loan, operating, and financial statistics section of the 1997 statistical report. We reviewed all 815 borrowers' financial information in the 1997 statistical report. We selected only those borrowers with ratios that were equal to or greater than the average TIER and net worth to total assets ratio and equal to or less than the average long-term debt-to-equity ratio of the 1998 PIF borrowers. In other words, we selected only those borrowers in which all three financial ratios (TIER, net worth to total assets, and long-term debt to equity) were equal to or better than the average of the PIF borrowers. Of the universe of 815 borrowers, 434 (53 percent) had better financial ratios than the PIF borrowers. The 434 borrowers and their key financial ratios are shown in exhibit C. A comparison of the RUS debts of the 434 borrowers with the universe of 815 borrowers is summarized in the table below.

Estimates of Borrowers That Could Obtain Financing From Other Sources as of 12/31/97 (Dollar Amounts in Thousands)

	(1) RUS BORROWERS REPORTING IN 1997	(2) BORROWERS CAPABLE OF OBTAINING OTHER FINANCING	(3) COLUMN 2 AS A PERCENTAGE OF COLUMN 1
NUMBER OF BORROWERS	815	434	53.3
RUS DEBT	$3,140,594	$1,193,234	38.0
RTB DEBT	1,359,233	595,514	43.8
FFB DEBT	314,931	85,829	27.3
TOTAL RUS/RTB/FFB DEBT	**$4,814,758**	**$1,874,577**	**38.9**

Of the 434 borrowers identified, 173 (39.9 percent) had a TIER greater than or equal to 10. The average TIER for these 173 borrowers was 95.37. Of the remaining 261 borrowers that had a TIER of less than 10, the average TIER was 6.27 (which is over 4 times the level necessary to qualify for a guaranteed loan). The key financial ratios of the 16 PIF borrowers and the 434 borrowers is summarized in the table below.

Financial Characteristics of the
16 PIF Borrowers and 434 Borrowers
With Better Financial Ratios
as of 12/31/97

FINANCIAL INDICATORS AS OF 12/31/97	COMPOSITE FOR ALL 815 BORROWERS	AVERAGE OF 16 PIF BORROWERS	AVERAGE OF 434 BORROWERS
TIER	4.65	3.98	6.27[5]
NET WORTH TO TOTAL ASSETS	50.3%	44.50%	65.00%
LONG-TERM DEBT TO EQUITY	70.5%	111.10%	40.00%

We concluded that these 434 borrowers who had combined RUS/RTB/FFB debts of $1.87 billion could likely satisfy their credit needs from their own financial organizations and/or other credit sources.

OTHER COMMERCIAL LENDERS

We contacted two commercial lenders (National Rural Utilities Cooperative Finance Corporation (NRUCFC) and Farm Credit System CoBank (CoBank)) who provide loans to electric and telephone companies. We requested NRUCFC and CoBank to identify the minimum acceptable equity ratio, debt to equity ratio, TIER, and/or other key financial ratios that telephone borrowers must have in order to obtain long-term loans from them.

NRUCFC informed us that in addition to evaluating financial ratios, it also considers the borrower's competitive position, quality of management, plant condition, and various other non-quantifiable features of the borrower's operation. NRUCFC stated that for a borrower to obtain a long-term loan, the company must be able to demonstrate the ability to achieve and maintain an annual debt service coverage ratio of 1.25:1 and an annual TIER of 1.5. We did not have the necessary data to compute the debt service coverage for the 434 borrowers we identified as being in strong financial condition; however, we determined the TIER for these 434 borrowers was 6.27 (see above table) which was over four times the TIER required by NRUCFC.

CoBank also informed us that there were a number of factors it considers in making loans in addition to financial ratios; however, it was CoBank's preference that telephone companies meet or exceed the following ratios:

- o Debt service coverage (minimum) - 1.25:1
- o Total debt to operating cash flow (maximum) - 6.0:1
- o Equity to assets (minimum) - 20 percent

[5]Average of the 261 borrowers who had a TIER less than 10.

We did not have the data to compute the debt service coverage for the 434 borrowers identified as being in strong financial condition; however, we determined the equity ratio for these 434 borrowers was 65 percent (see above table) which was more than three times greater than the CoBank minimum. In addition, the data available was sufficient to compute total debt to operating cash flow. To test this ratio against the 434 borrowers we identified as being in strong financial condition, we computed the total debt to operating cash flow for a random sample of 44 of these 434 borrowers and found that all 44 borrowers had a debt to operating cash flow ratio of less than 6.0:1. The ratios for the random sample of 44 borrowers ranged from 0.42:1 to 5.93:1 and averaged 2.55:1.

Therefore, it is likely that all 434 borrowers that we determined were in strong financial condition also substantially exceeded the financial ratios required by NRUCFC and CoBank.

LOAN APPLICATIONS CARRIED OVER TO THE NEXT FISCAL YEAR

RUS provided information regarding borrowers whose loan requests were not met because loan funds had been obligated to other borrowers. RUS data showed that loan applications totaling over $198 million from 26 borrowers since fiscal year (FY) 1995 were carried over to the next fiscal year due to lack of available funding during the fiscal year in which the loan applications were received (2 borrowers were carried over two fiscal years). Exhibit D shows the loan applications carried over to the next fiscal year due to lack of available funding.

RUS also provided information regarding the number and amount of loans made since FY 1995. RUS data showed that 198 borrowers received hardship, cost of money, and/or RTB loans totaling over $1.9 billion during FY's 1995 through FY 1999 as of August 31, 1999 (11 borrowers received loans in two fiscal years).

We compared RUS' list of 198 borrowers who received loans since FY 1995 to the list of borrowers we identified as being in strong financial condition as of December 31, 1997 (exhibit C), and found that 61 borrowers (5 borrowers received loans in two fiscal years) who received loans totaling $707.1 million were included in our list of financially strong borrowers (includes $70.8 million hardship, $400.6 million cost of money, and $235.7 million RTB).

We concluded that some borrowers were required to wait for the subsequent fiscal year's funding because loan funds had been obligated to borrowers who were in strong financial condition. Of the 26 borrowers in exhibit D that had to wait until the next fiscal year for funding, 20 were not included in exhibit C as borrowers in strong financial condition. These 20 borrowers were denied funding while other financially stronger borrowers were approved for loans.

RECOMMENDATION NO. 1

Work with Congress to clarify RUS policy for the telephone loan program regarding loan graduation and requiring financially strong borrowers to obtain credit from commercial sources.

RECOMMENDATION NO. 2

If Congress determines that RUS should graduate financially strong borrowers to commercial credit sources and require financially strong borrowers to obtain credit from other sources, RUS should develop a strategy to:

- Submit annual appropriation requests for telephone program loan funds based on anticipated assistance to borrowers who are unable to finance their credit needs internally or from non-Government sources.
- Require borrowers to have been denied commercial credit as a condition for RUS financial assistance.
- Establish a graduation program to assist financially strong borrowers to refinance their outstanding direct loans to other credit sources.
- Evaluate the financial condition of all borrowers and require those borrowers in strong financial condition to graduate their outstanding direct loan balances to other credit sources (including the borrowers cited in exhibit C with loans totaling $1.87 billion).

RUS Response

In his January 24, 2000, written response to the draft report, a copy of which is included in exhibit F, the RUS Acting Administrator disagreed with Recommendation No. 1. The following is a summary of the Acting Administrator’s response to Recommendation No. 1:

- It is inappropriate and unnecessary for RUS to lobby Congress for support of program funding or commercial graduation. Congress has not permitted the telecommunications program to operate in a vacuum; rather it has ensured that RUS-financed systems provide state-of-the-art telecommunications services thereby enabling rural subscribers the same economic, educational, and health care opportunities as urban and suburban residents.
- Congress reaffirmed its commitment to the role of the telecommunications program by increasing funding for the Rural Telephone Bank (RTB) from the $157 million proposed in the President’s FY 2000 budget to $175 million. This support demonstrates that Congress is aware of the need for RUS financing in rural areas and the value of RUS loan program participation and does not consider loan graduation prudent in today’s telecommunications industry.

- Congress reinforced RUS’ role for telecommunications through the passage of the Rural Electrification Loan Restructuring Act (RELRA) of 1993 which reinforced the objective of the RE Act to fully utilize appropriated funds to provide modern, affordable telecommunications service in rural areas. The RELRA mandated new service standards for RUS borrowers and strengthened RUS’ authority to utilize all funding available to it for the benefit of rural America. RELRA not only includes requirements for borrower financial strength, but also focuses on the characteristics of the rural areas in which RUS loan funds will be directed, and the types of service that will be required to be provided to these areas.

- The RELRA also mandated that cost-of-money loans be made concurrently with RTB loans. Had Congress intended for borrowers to seek concurrent or supplemental funding from non-Government sources, it would have amended RELRA accordingly. Rather, Congress specifically identified the RTB as the appropriate supplemental lender. Per Section 305(d) of the RE Act, Congress is more concerned with the characteristics of the rural areas served by RUS borrowers and the types of services provided in those areas than the financial strength of the RUS borrowers themselves.

- Telecommunications parity between rural and urban America is at a greater risk today than any other time in this nation’s history. The "lockout" of borrowers through a graduation process would only be detrimental to the Congressionally mandated national telecommunications policy framework. The Telecommunications Act of 1996 deregulated local telephone service and created a competitive marketplace. Such change promises to bring new carriers into the profitable telecommunications markets including America’s cities and larger towns, with the intended result of competitive pricing and innovation. However, rural areas are not likely to benefit from such competition and local exchange carriers will be left to cope with rising per-customer costs and decreasing per-customer revenues.

- Further complicating the deregulation transition is the Telecommunications Act requirement for Federal and State regulators to reform the decades old revenue sharing mechanisms. The Federal Communications Commission also made a change in the universal service mechanism for large local exchange carriers.

- The chasm between those "on-line" and those "off-line" still persists and, for rural areas, is even wider and more difficult to overcome when considering the additional barriers of time and distance. Rural citizens are among the least connected to telephone and computer access services and many rural areas have no service at all. The lower population density of America’s rural areas almost automatically creates a disincentive for companies to make investments in telecommunications.

- The analysis of financial strength presented in the OIG report is misleading. On the whole, RUS telecommunications borrowers enjoy a relatively stable financial condition. As noted in the audit report, the average TIER and equity ratios are good. However, the nature of the telecommunications industry is rapidly changing, both from a technological standpoint and an operational standpoint. New investment for new technologies and services is required at an increasing rate and private capital providers will seek the most secure investment opportunities in urban and suburban areas, leaving rural areas behind. RUS financing is an important component of the universal service equation and provides the capital necessary to ensure that rural areas receive the same service offerings as their urban counterparts.

- The information provided in the report is misleading as to the strength of RUS' borrowers and their ability to raise capital from private lenders. It is important to note that TIER requirements for obtaining new financing are based on projected financial performance that includes both the new debt and interest expense, not on current financial performance. The 128 borrowers that received loans during FY's 1997, 1998, and 1999 had an average projected TIER of 1.91 and a median TIER of 1.67. Nearly 44 percent had projected TIER's of less than 1.5 and 81 percent had projected TIER's less than 2.5.

- RUS is a rural economic development stimulator that utilizes attractive financing as a tool to encourage rural utilities to build modern telecommunications plant and provide high quality service to all who work or reside within their assigned territories. The primary objective of the telecommunications program is to ensure that rural subscribers have modern, reliable utility service so that they can work, learn, and live like their urban and suburban counterparts. The very success of the RUS program is built, in part, on the financial stability of its borrowers. In 50 years of RUS service, not one telecommunications borrower has defaulted on a loan.

Regarding Recommendation No. 2, the Acting Administrator's written response stated that through the enactment of the RELRA and the Telecommunications Act of 1996 and through continued appropriation funding support, Congress has demonstrated that it is not its intent to require financially strong borrowers to obtain credit from other sources. To do so would be contrary to the purpose and operation of RELRA; therefore, it is unnecessary to develop the strategy detailed in Recommendation No. 2.

OIG Position

The audit report does not suggest that RUS conduct illegal lobbying activities to obtain Congressional support for program funding or graduation of borrowers to other credit sources. Congress has already determined that RUS is to encourage and assist rural telephone systems to develop their resources and ability to achieve the financial strength needed to enable them to satisfy their credit needs from their own financial organizations and other sources (Title 7 USC 930). This report recommends that RUS work with Congress to clarify policy for the telephone loan program regarding graduating loans to other credit sources and requiring financially strong borrowers to meet their credit needs from their own organizations and/or other sources. As pointed out in this report, RUS has done an excellent job of assisting telephone borrowers achieve financial strength. During the 17-year period 1981 through 1997, the average TIER for all telephone borrowers more than doubled from 2.25 to 4.65; net worth as a percent of total assets nearly doubled from 25.3 percent to 50.3 percent; and debt to equity decreased over two-thirds from 234.8 percent to 70.5 percent.

However, RUS has done very little to encourage and assist financially strong borrowers to satisfy their credit needs from their own financial organizations and other sources. We identified over 400 telephone borrowers with RUS loans totaling over

$1.8 billion who were in strong financial condition and likely could satisfy their credit needs from their own financial organizations and/or other sources. For RUS to provide such information to Congress is not lobbying; rather, it is keeping Congress informed of the telephone program's success in assisting borrower's achieve financial strength and obtaining Congressional guidance in meeting the intent of law to encourage and assist financially strong telephone borrowers to satisfy their credit needs from their own financial organizations and/or other sources.

The fact that Congress increased funding for RTB and/or RUS loans does not necessarily mean that Congress does not consider loan graduation prudent in the telecommunications industry or that financially strong borrowers should not be assisted to meet their credit needs from other sources. This report does not state nor imply that there is no need for RUS financing in rural areas. However, the report illustrates that there are a significant number of borrowers (over 50 percent) who likely could finance their proposed credit needs from their own financial organizations and/or other sources.

The Acting Administrator also stated that Congress has demonstrated through the enactment of the RELRA and the Telecommunications Act of 1996 and continued appropriated funding support for RUS programs that it is not its intent to require financially strong borrowers to obtain credit from other sources. We do not believe that these actions by Congress eliminated the Congressional mandate in Title 7 USC 930 which requires RUS to encourage and assist rural telephone systems to develop their resources and ability to achieve the financial strength needed to enable them to satisfy their credit needs from their own financial organizations and other sources. Rather than risk a misunderstanding of Congressional intent of continued funding of RUS programs, we believe RUS should specifically determine whether or not Congress intends for RUS to encourage and assist rural telephone systems to develop their resources and ability to achieve the financial strength needed to enable them to satisfy their credit needs from their own financial organizations and other sources.

The agency response stated that it is the objective of the RE Act to fully utilize appropriated funds to provide telecommunications service to rural areas. Telephone borrowers who serve rural areas and do not benefit from the competitive market place and revised revenue sharing as a result of the Telecommunications Act of 1996 may need RUS financial assistance to provide affordable service to rural areas. However, as noted in the audit report, RUS' annual appropriation budget request is based on anticipated loan requests from all applicants regardless of financial condition. If RUS submitted appropriation requests based on anticipated financial needs of borrowers who need RUS assistance, the agency could not only reduce spending millions of tax dollars for telephone companies who do not need Government assistance, but also develop a needs-based budget request.

The response also stated that Congress is more concerned with the characteristics of rural areas and the services provided to those areas than financial strength of borrowers. The response emphasized that RUS provides financial assistance to borrowers who service rural areas. In the initial RE Act, a borrower could not obtain a loan if the service area included a city or populated area greater than 1,500. In 1993, the maximum population level was increased to 5,000. However, RUS applies this population restriction only to the initial loan. Population is not considered for subsequent loans to borrowers. This is popularly known as the "once rural, always rural" rule. The RE Act, as amended, does not explicitly have this provision. Title 7 USC 930 states that it is the policy of Congress that adequate funds should be made available to "rural" telephone systems. Thus, RUS continues to provide loans to telephone companies who are not only in strong financial condition, but who service areas that currently exceed the maximum population of 5,000.

For example, the initial loan for borrower AZ 506, headquartered in Kingman, Arizona, was made in 1964. At that time, the service area for AZ 506 did not contain populated areas greater than 1,500. In 1998, AZ 506 obtained a $41 million loan. By this time, the populations of Bullhead City and Lake Havasu, which are in AZ 506's service area, were estimated to be 27,370 and 37,580, respectively, when the borrower's loan design was prepared in 1996. Therefore, the populations of these two areas were estimated to be 447 percent and 652 percent greater than the applicable population limit of 5,000.

In addition, the fact that Congress mandated in the RELRA that cost-of-money loans be made concurrently with RTB loans does not necessarily mean that Congress does not intend for financially strong borrowers to seek funding from other sources. Although the RELRA and RE Act outline the characteristics of rural areas serviced by RUS borrowers, the acts do not override the requirement of Title 7 USC 930 to encourage and assist rural telephone systems to develop their resources and ability to achieve the financial strength needed to enable them to satisfy their credit needs from their own financial organizations and other sources.

We also disagree that a loan graduation program would "lockout" borrowers from RUS financial assistance and be detrimental to the national telecommunications policy. Loan graduation would only affect borrowers who achieve a strong financial position and, therefore, are able to satisfy their credit needs from their own financial organizations and/or refinance their RUS loans through other credit sources. A loan graduation program would not affect loan applications from borrowers who need RUS financial assistance.

The OIG analysis of financial strength of borrowers presented in the report illustrates that over half of the telephone borrowers are in strong financial condition. Although new financing may be based, in part, on projected financial performance, current financial performance is a key indicator of a borrower's future performance and its ability to repay a new loan. A borrower's current financial condition has a direct relationship on the borrower's ability to obtain financing from other credit sources. The response stated that 128 borrowers who received loans during FY's 1997, 1998, and 1999 had an average projected TIER of 1.91. As noted in this report, 61 of the 198 borrowers who received RUS loans totaling $707.1 million during FY's 1995 through August 31 of FY 1999 (5 borrowers received loans in two fiscal years) were included in our list of financially strong borrowers.

In addition, a borrower's projected financial condition (such as TIER) for the purpose of obtaining a new loan would have no effect on a loan graduation program. In a loan graduation program, the borrower's current financial condition is the determining factor as to whether or not the borrower should be graduated to other credit sources. Projected financial ratios such as TIER are applicable for evaluating a borrower's ability to repay a new loan; however, current financial ratios are applicable to a loan graduation program. Our list of over 400 financially strong borrowers had an average TIER of 6.27. The composite TIER for all telephone borrowers was 4.65 as of December 31, 1997, according to the financial information reported to RUS by the borrowers.

We believe that it would be prudent for RUS to keep Congress apprised of the financial condition of telephone company borrowers and to work with Congress to determine whether it continues to be Congressional intent and policy that financially strong borrowers should be encouraged and assisted to obtain financing from their own financial organizations and/or other credit sources per Title 7 USC 930. If it is still Congressional policy to encourage and assist financially strong borrowers to meet their credit needs from other sources, RUS needs to initiate immediate action to implement this policy.

We request that RUS reconsider its management decision for Recommendation No. 1 and develop a strategy to work with Congress to clarify RUS policy for loan graduation and requiring financially strong borrowers to obtain credit from other sources. To reach agreement with RUS' management decision for Recommendation No. 1, we need documentation showing the specific action to be taken and the timeframe within which the corrective action will be completed.

If Congress determines that financially strong borrowers should be graduated to commercial credit sources, we need the following information to reach agreement with the management decision regarding Recommendation No. 2: (1) Documentation showing the specific corrective action to be taken, (2) the timeframe within which the corrective action will be completed, and (3) a list of the borrowers (and their loan amounts) determined to be in strong financial condition and selected for graduation to other credit sources.

CHAPTER 2. UNUSED LOAN FUNDS NOT DEOBLIGATED

FINDING NO. 2

RUS did not deobligate unused loan funds for aged loans. RUS personnel did not periodically review loans to determine if the purposes for which the loans were made had been accomplished. As a result, $602,260,826 in unused loan funds committed to 409 loans over 5 years old had not been reviewed for deobligation.

The GAO Principles of Federal Appropriations Law, dated December 1992, states that an obligation creates a liability on the part of the Government to make a payment at a later time. Title 31, USC 1501, dated September 13, 1982, states, in part, that an amount shall be recorded as an obligation of the Government when supported by documentary evidence of a loan agreement showing the amount and terms of repayment. Title 31, USC 1108, dated July 1, 1970, provides that the head of an agency shall submit an annual certification showing compliance with Title 31, USC 1501. Agencies are required to review unliquidated obligations prior to certification. The Department of the Treasury Financial Manual Bulletin 98-09, dated August 10, 1998, states that agencies that have not reviewed their unliquidated obligations during the year must do so before year end closing. This review is to ensure that those transactions meeting the criteria of valid obligations set forth in Title 31 USC 1501 have been properly recorded.

A previous OIG audit[6] revealed that the agency did not always rescind unadvanced loan funds because it did not place priority on this task and that agency officials were reluctant to deobligate loan funds because deobligated funds are not available to other borrowers. The agency agreed to implement a policy to automatically rescind all unadvanced loan fund commitments at the end of six years from loan approval or when the loan purposes are completed.

Subsequently, in 1990, Congress amended Section 206, of the RE Act (Title 7 USC 927(b)(1)) to provide that neither the Secretary nor the Governor of RTB shall rescind an insured telephone loan or an RTB loan without the consent of the borrower unless all of the purposes of the loan have been accomplished.

RUS personnel stated that they do not deobligate unadvanced loan balances because Section 206 of the RE Act prohibits RUS from deobligating funds without the consent of the borrower. In our opinion, Section 206 did not prohibit rescinding loans and deobligating unused loan funds. Rather, it established the conditions under which this is to occur (i.e., when all purposes of the loan have been completed). It is, therefore, appropriate that RUS establish administrative procedures to determine when loan purposes have been accomplished and to deobligate unused loan funds when that occurs. Currently, there are no administrative procedures to accomplish this.

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[6]OIG report No. 09614-2-Te, Telephone Loan Making Policies, issued June 1985.

On January 20 and February 9, 1999, the Director of the Electric and Telephone Financial Operations Division issued letters requesting the Assistant Administrator for Telecommunications Programs to review an enclosed list of RUS and RTB loans, respectively, that were approved 5 or more years ago that still had unadvanced loan funds. The letters requested the assistant administrator to advise the financial operations division if the obligations were still valid or to prepare loan rescissions. The letter stressed the importance of properly reporting unliquidated obligations to Congress, the Office of Management and Budget, and the Department of Treasury. The director stated that he did not receive a written response, but he was told that RUS did not rescind unadvanced funds.

We aged the information included in the letters for RTB and RUS loans and analyzed the loans that had previous drawdowns with the last drawdown made at least 1 year prior to January 1, 1999. We then scheduled, by year, the number and amount of loans that had no advances for the last 10 years. Loans that had their last advance over 10 years prior were grouped together.

We identified 241 RUS and 116 RTB loans that were made more than 5 years prior to January 1, 1999, that had unadvanced funds totaling $274,388,088 and $164,520,688 respectively. See exhibit E for a breakdown of the unused funds by years. For example, RUS borrower AL-528 had an unadvanced amount of almost $10 million and the last advance of funds was in April 1990. RTB borrower IA-510 had an unadvanced amount of over $7.5 million and the last advance of funds was in April 1989.

In addition, the letters identified 16 RUS loans totaling $44,701,000 and 36 RTB loans totaling $118,651,050 that were made over 5 years ago for which funds had never been advanced. For example, borrower LA-527 had an unadvanced RUS loan of $6.8 million and borrower OK-563 had an unadvanced RTB loan of $8.4 million.

In summary, there were 409 RUS and RTB loans over 5 years old that had unused fund balances totaling $602,260,826. Unused telephone program loan funds should be periodically deobligated because unused funds that are no longer needed result in an overstatement of loan obligations on the agency’s financial statement. RUS needs to take administrative action to reduce outstanding obligations of loans for which the loan purposes have been accomplished.

RECOMMENDATION NO. 3

Implement procedures to evaluate telephone loans, at least annually, to determine if the purposes for which the loans were made have been accomplished and deobligate all funds that are not needed.

RECOMMENDATION NO. 4

Review the RUS and RTB loans made over 5 years ago and determine how much of the cited $602,260,826 in unadvanced funds should be deobligated.

RUS Response

In his written response to the draft report (see exhibit F), the Acting Administrator cited Section 206 of the RE Act and stated that because of the improbability of ever making the legislatively mandated determination that all of the purposes of a loan have been accomplished, RUS has not developed procedures to unilaterally deobligate loan funds.

The Acting Administrator stated, however, that telecommunications loans are evaluated on an ongoing basis to determine if the purposes for which the loans were made have been accomplished. With the consent of the borrower, RUS has deobligated funds that are no longer needed. The response showed that during FY’s 1997 through 1999, RUS deobligated $318 million from 108 loans to 75 borrowers.

The Acting Administrator stated that RUS routinely notifies borrowers who have exceeded or are about to exceed their note basis period (usually 6 years) that funds remain unexpended and asks the borrower if all or a portion of the unadvanced loan funds could be rescinded if they are no longer needed. RUS offers to prepare a new basis date agreement (usually for 3 years) if the borrower justifies the need for the funds. For those notes which do not restrict advances after a specific number of years, RUS follows up with letters to determine if unadvanced loan funds may be rescinded. Telecommunications program field representatives also discuss the need for unadvanced loan funds when they visit borrowers.

The Acting Administrator stated that based on these procedures, the telecommunications program has the necessary measures in place to monitor and deobligate unadvanced loan funds with borrower concurrence. The Acting Administrator said due to the legislatively mandated requirement for borrower concurrence, it would be improper for RUS to unilaterally deobligate unadvanced funds.

OIG Position

Section 206 of the RE Act did not prohibit the deobligation of unused loan funds, but established the conditions under which this is to occur (i.e., when all purposes of the loan have been accomplished). The Act states that loan funds shall not be rescinded without borrower consent unless all of the purposes of the loan have been completed. Therefore, RUS should establish procedures to deobligate unused loan funds when it is determined that the loan purposes have been accomplished. We agree that RUS must work closely with borrowers to make this determination and strive to obtain agreement that any unused loan funds are no longer needed; however, borrower consent is not a requirement if the purposes of the loan have been accomplished.

As noted in the finding above, Federal statutes (Title 31 USC 1108 and 1501) require that the head of an agency submit an annual certification regarding obligations and that unliquidated obligations are to be reviewed prior to the certification. We identified over 400 loans over 5 years old that had unused fund balances totaling over $600 million that RUS needs to review and make determinations regarding the accomplishment of loan purposes. If it is determined that the purposes of the loans have been accomplished, the agency should take action to deobligate the unadvanced loan funds.

In addition, we were informed during the audit that RUS did not have a procedure whereby unadvanced loan funds were routinely reviewed and deobligated if the funds were no longer needed. The Acting Administrator's written response describes a procedure whereby unadvanced loan balances are routinely reviewed and deobligated, and provides summary data showing deobligations for 75 borrowers totaling $318 million during FY's 1997, 1998, and 1999. In order to fully understand the deobligation review process, please provide any written procedures for this review process and the supporting documentation for the cited loan deobligations.

To reach agreement with the management decision for Recommendation No. 3, we need documentation showing the specific corrective action to be taken and the timeframe within which the corrective action will be completed.

To reach agreement with the management decision for Recommendation No. 4, we need documentation showing the specific corrective action to be taken, the timeframe within which the corrective action will be completed, and the amount of unadvanced loan funds to be deobligated.

EXHIBIT A - SUMMARY OF MONETARY RESULTS

FINDING NO.	DESCRIPTION	AMOUNT	CATEGORY
1	Loans to financially strong borrowers that could have obtained financing from other sources and/or could be graduated to other credit sources	$1,874,577,197	Questioned Loans, No Recovery
2	Unused loan fund balances not deobligated	602,260,826	FTBPTBU: Deobligations
	TOTAL	**$2,476,838,023**	

FTBPTBU = Funds to be put to better use.

EXHIBIT B - SELECTED RUS BORROWERS THAT PAID LOANS IN FULL IN 1998

BORROWER	TIER	EQUITY RATIO	DEBT TO EQUITY RATIO	FINAL PAYMENT AMOUNT	YEARS NOTE PAID IN ADVANCE
AK 514	2.05	33.7%	175.5%	$ 4,020,611	23.9
FL 516	2.11	52.7%	69.9%	3,537,026	26.4
GA 543	2.29	37.4%	138.8%	24,494,190	24.8
IA 610	8.80	52.9%	78.1%	1,054,050	18.2
IA 616	7.26	51.6%	75.2%	1,093,785	23.4
ID 505	2.97	36.9%	133.6%	2,435,153	18.6
IN 503	8.76	70.1%	22.6%	3,995,973	15.6
ME 506	1.34	31.0%	170.8%	2,640,479	25.2
ME 527	3.03	35.6%	101.8%	1,796,977	23.0
ME 530	3.65	50.0%	59.7%	3,860,098	26.2
OK 532	3.48	41.5%	73.7%	507,098	7.4
OK 542	2.28	19.8%	318.5%	7,021,573	23.9
OR 525	4.83	69.2%	22.0%	2,762,370	22.8
SC 519	2.30	34.7%	165.3%	62,996,633	29.7
TX 576	3.31	36.3%	121.6%	241,268	20.3
VA 521	5.28	58.0%	50.0%	3,128,014	31.5
TOTAL				**$125,585,298**	
AVERAGES	**3.98**	**44.5%**	**111.1%**	**$ 7,849,081**	**22.6**
TOTAL NUMBER OF BORROWERS		**16**			

NOTE: Final payment amount not provided for FL 516. The amount shown is total RUS/RTB debt on 12/31/97. The debt was paid in full on 1/08/98.

EXHIBIT C - TELEPHONE LOAN BORROWERS IN STRONG FINANCIAL CONDITION AS OF DECEMBER 31, 1997

BORROWER	TIER	NET WORTH TO TOTAL ASSETS	TOTAL LONG-TERM DEBT TO EQUITY	LONG-TERM DEBT		
				RUS	RTB	FFB
AK 526	4.61	52.6%	62.7%	$6,040,892	$18,248,888	$17,343,922
AL 501	6.01	64.5%	38.0%	4,292,854	6,734,867	
AL 502	6.07	56.1%	45.7%	1,979,137	7,323,946	
AL 516	8.24	57.4%	49.3%	7,233,511	336,720	
AL 519*	5.25	47.9%	99.8%	3,566,213	976,500	
AL 523	5.64	49.2%	61.7%	2,417,265	86,983	
AL 524	13.33	57.9%	48.9%	6,014,672	310,712	
AL 528	4.81	62.5%	50.4%	13,078,758	923,619	
AL 534	13.14	64.8%	33.6%	2,979,882		
AL 542	4.48	55.1%	63.5%	2,545,613	465,114	
AL 550	11.58	46.1%	57.1%	4,198,618	6,214,280	399,946
AL 553	5.68	54.7%	55.5%	5,764,697		
AL 561	10.92	68.5%	29.6%		1,495,835	
AR 515	5.51	57.2%	66.4%	2,949,747		
AR 530	6.31	44.8%	92.7%	10,937,391		
AR 531	4.98	47.3%	81.3%	7,936,715		
AR 534	12.57	75.5%	26.0%	39,688	1,163,421	
AR 538	4.87	49.6%	59.5%	12,687,257	41,775,030	7,182,069
AR 545	4.73	66.9%	32.4%	1,265,690		
AR 547	5.97	55.0%	46.1%	12,067,546		
AZ 507	5.13	57.4%	60.0%	6,898,363	2,540,283	
AZ 508	11.63	53.3%	56.8%	3,879,341		
AZ 510*	36.93	73.7%	33.6%	5,541,724		
CA 515*	6.25	59.7%	27.0%	5,812,540	3,137,906	1,901,610
CA 517	4.88	50.8%	71.4%	658,091	7,470,374	
CA 523	6.80	59.8%	51.9%	7,036,597	4,369,909	992,499
CA 531	28.83	66.8%	24.7%	1,400,935	410,800	
CA 535	443.39	65.6%	39.4%	2,066,634	363,860	

EXHIBIT C - TELEPHONE LOAN BORROWERS IN STRONG FINANCIAL CONDITION AS OF DECEMBER 31, 1997

BORROWER	TIER	NET WORTH TO TOTAL ASSETS	TOTAL LONG-TERM DEBT TO EQUITY	LONG-TERM DEBT		
				RUS	RTB	FFB
CA 539	4.44	62.5%	46.7%	5,741,179	711,399	
CA 540	13.93	60.0%	35.4%	1,960,607		
CA 541	26.19	73.8%	17.1%	1,360,293		
CA 543	10.39	71.3%	26.4%	1,263,987	238,987	
CO 501	20.65	74.0%	26.9%	968,691		
CO 514	8.47	64.9%	34.9%	4,460,964		
CO 527	14.54	71.0%	28.5%	536,562		
CO 528**	5.05	73.6%	25.8%	889,072		
CO 531	34.78	68.0%	18.7%	352,020		
CO 533	5.73	55.5%	57.7%	973,834		
CO 534	20.29	73.1%	22.1%	378,680		
GA 541	5.64	70.0%	30.0%	1,984,829	685,992	
GA 545	10.08	54.3%	43.3%	2,187,626		
GA 553	5.91	73.8%	15.1%	5,609,032		
GA 554	6.45	46.8%	65.1%	6,470,169	4,611,321	8,906,941
IA 503	49.92	83.2%	7.5%	114,705	535,363	
IA 506	4330.08	90.0%	5.9%	287,542	347,178	
IA 507*	11.07	69.6%	28.3%	1,279,671		
IA 508*	4.80	66.8%	44.7%	71,294	2,603,651	
IA 510	66.73	92.2%	2.7%	(155,849)	404,920	
IA 511	1648.79	98.6%	0.4%	35,741		
IA 515	16.68	71.0%	31.4%	275,472		
IA 519	31.25	69.2%	33.1%	261,273	610,013	
IA 520	9.44	67.1%	41.8%	351,908	2,312,674	
IA 521	7.32	64.9%	47.0%	977,873	1,125,348	
IA 523	122.66	83.3%	14.1%	1,683,810		
IA 524	266.50	94.6%	2.6%	97,969		
IA 528	12.99	57.0%	55.9%	612,272		

EXHIBIT C - TELEPHONE LOAN BORROWERS IN STRONG FINANCIAL CONDITION AS OF DECEMBER 31, 1997

BORROWER	TIER	NET WORTH TO TOTAL ASSETS	TOTAL LONG-TERM DEBT TO EQUITY	LONG-TERM DEBT		
				RUS	RTB	FFB
IA 535	117.24	85.7%	6.1%	250,976		
IA 536	18.16	67.8%	25.7%	183,615		
IA 541	9.32	57.2%	55.1%	1,441,139	136,731	
IA 555	13.00	63.5%	42.9%	688,562		
IA 558	14.12	67.5%	39.4%	669,120		
IA 560*	708.24	96.5%	0.4%	10,052		
IA 562	31.89	81.5%	19.2%	216,240		
IA 563	169.32	89.3%	6.4%	180,346		
IA 570	11.14	71.7%	34.9%	1,056,027		
IA 571	8.75	70.0%	28.4%	280,423	2,778,160	
IA 574	203.68	83.7%	5.3%	95,092		
IA 575	8.17	79.1%	23.2%	1,199,284	4,462,940	
IA 578	20.19	52.2%	68.8%	2,044,218		
IA 579	10.19	55.0%	73.6%	432,652	562,303	
IA 584	9.82	69.1%	36.1%	575,645		
IA 585	6.06	66.9%	32.7%	1,833,991		
IA 586	13.54	75.2%	24.0%	427,489		
IA 587*	39.88	72.0%	19.1%	919,796		
IA 592	918.88	85.1%	12.0%	373,764		
IA 594	7.85	79.4%	20.4%	3,456	227,072	
IA 596*	435.17	97.1%	0.5%	34,940		
IA 597	20.13	59.8%	42.4%	1,042,627		
IA 603	5.92	61.8%	49.6%	989,505		
IA 604	26.98	87.9%	4.1%	106,191		
IA 605	38.51	77.9%	14.0%	195,133		
IA 606	13.08	75.1%	18.1%	217,233		
IA 608	5.95	64.4%	46.2%	136,600	303,321	
IA 609	55.35	93.0%	0.0%	804		

EXHIBIT C - TELEPHONE LOAN BORROWERS IN STRONG FINANCIAL CONDITION AS OF DECEMBER 31, 1997

BORROWER	TIER	NET WORTH TO TOTAL ASSETS	TOTAL LONG-TERM DEBT TO EQUITY	LONG-TERM DEBT		
				RUS	RTB	FFB
IA 610	8.80	52.9%	78.1%	299,728	1,002,594	
IA 613	62.24	83.9%	6.0%	24,074	283,363	
IA 614	141.52	87.2%	7.2%	65,236		
IA 616	7.26	51.6%	75.2%	1,097,234	1,026,930	
IA 619	16.06	82.9%	16.6%	276,330	162,189	
IA 620	7.67	71.6%	33.9%	877,391	38,195	
IA 622	23.94	85.5%	4.7%	238,947		
IA 623	14.84	62.9%	42.2%	686,632		
IA 625	25.52	86.2%	9.4%	393,530		
IA 632	957.77	84.0%	7.9%	231,518		
IA 634	12.24	60.7%	37.6%	841,705		
IA 636*	8.45	70.8%	31.0%	399,347		
IA 640	13.26	73.8%	22.6%	224,956		
IA 641	6.62	54.8%	60.4%	945,853		
IA 643*	4.38	50.7%	85.5%	896,438		
IA 644	6.53	56.8%	69.6%	1,113,376		
IA 650	4.39	72.9%	29.5%	813,735		138,634
IA 651	4.72	66.4%	37.6%	917,400		
IA 656*	44.43	89.0%	8.2%	213,394		
IA 657	26.52	68.8%	30.5%	628,917		
ID 503	7.32	74.2%	28.1%	1,378,127		
ID 504	9.83	67.3%	34.3%	2,003,124		
ID 506	13.96	75.2%	22.7%	3,315,885		
IL 510	6.39	52.5%	76.0%	490,930	207,655	
IL 511	4.11	52.6%	78.4%	3,279,174	1,616,294	
IL 513*	8.94	65.9%	32.8%		2,504,863	
IL 516	5.42	69.4%	31.2%	1,357,598	1,744,604	
IL 517	5.83	52.9%	79.7%	2,154,410	2,201,519	

EXHIBIT C - TELEPHONE LOAN BORROWERS IN STRONG FINANCIAL CONDITION AS OF DECEMBER 31, 1997

BORROWER	TIER	NET WORTH TO TOTAL ASSETS	TOTAL LONG-TERM DEBT TO EQUITY	LONG-TERM DEBT		
				RUS	RTB	FFB
IL 518	8.58	74.5%	28.2%	4,026,009		
IL 522	11.61	74.2%	28.5%	1,253,981		
IL 523	46.73	86.1%	7.2%	237,948		
IL 526	47.90	76.8%	5.0%	(4,324)	110,501	
IL 547	35.03	86.3%	6.9%	104,188	795,469	
IL 553	25.68	67.2%	11.8%	382,885	866,146	
IL 560	178.52	94.9%	1.4%	81,110		
IL 562	61.06	78.7%	10.8%	170,098		
IL 567	26.51	83.0%	13.5%		512,400	
IL 569	16.31	74.7%	14.7%	173,398	253,947	
IL 570	5.23	52.3%	40.2%	421,563	129,594	
IL 572	4.76	56.0%	54.5%		1,271,464	
IL 574	14.99	81.8%	12.9%		285,289	
IN 503	8.76	70.1%	22.6%	4,933,260	3,959,889	
IN 522	8.30	61.9%	43.9%	1,906,605	995,360	
IN 523	297.79	89.0%	1.9%	46,385		
IN 524	48.96	87.9%	7.0%	2,244,220		
IN 530	9.90	66.9%	43.8%	2,330,101	765,215	
IN 531	13.05	76.8%	25.4%	862,039	188,792	
IN 540	114.53	71.2%	9.5%	200,410		
IN 541*	4.24	50.4%	73.7%	2,808,574	1,432,493	
IN 543	35.78	79.2%	0.1%	3,509		
IN 546	7.92	67.3%	42.2%	571,175		
IN 552	792.57	95.5%	0.6%	10,870		
IN 560	6.74	70.6%	35.2%	1,423,129		
IN 561	9.33	65.1%	31.1%	936,260		
IN 563	9.78	67.8%	26.6%	682,042	3,921,021	
IN 567	24.76	87.8%	10.3%		675,563	

EXHIBIT C - TELEPHONE LOAN BORROWERS IN STRONG FINANCIAL CONDITION AS OF DECEMBER 31, 1997

BORROWER	TIER	NET WORTH TO TOTAL ASSETS	TOTAL LONG-TERM DEBT TO EQUITY	LONG-TERM DEBT		
				RUS	RTB	FFB
IN 568	6.69	63.6%	29.5%	781,329	141,789	
IN 569	4.51	46.1%	85.8%	3,649,040	585,265	
KS 520	52.49	85.3%	10.5%	3,604,014		
KS 526	6.98	52.5%	59.5%	1,333,366	1,264,814	
KS 537**	6.40	48.7%	56.8%	12,653,038		
KS 543	40.27	64.9%	31.8%	961,387		
KS 547*	4.04	48.8%	92.2%	7,273,166		
KS 549	13.74	70.7%	37.8%	2,285,920		
KS 552*	38.03	52.2%	85.2%	5,817,696	157,030	
KS 569	13.87	65.1%	47.9%	2,806,734		
KS 571	54.13	80.1%	13.7%	618,720		
KS 574*	7.99	50.1%	84.5%	4,294,978	424,330	
KS 576*	13.27	56.9%	65.2%	4,714,568		
KS 580	10.30	74.1%	23.9%	1,044,896	873,657	
KS 581	5.48	54.1%	63.0%	1,218,975	2,510,765	
KS 583	8.19	59.7%	59.5%	4,475,242		
KS 585	5.71	47.7%	82.2%	1,818,506		
KS 589	14.28	74.3%	16.9%	793,782		
KY 505	4.53	46.7%	103.3%	38,750,533	208,267	
KY 506*	7.36	61.3%	45.2%	10,493,076	90,705	
KY 522*	4.26	53.8%	75.0%	12,610,732	2,433,128	
KY 524	11.14	64.7%	25.3%	462,716	4,794,007	
KY 530*	4.84	46.8%	81.3%	10,896,644	4,694,409	
KY 531	7.56	51.2%	52.7%	2,602,548	4,102,730	
KY 532**	5.73	50.0%	89.4%	7,924,245	2,515,946	
KY 534	4.77	56.4%	50.7%	128,646	1,807,476	
KY 536*	6.42	64.8%	41.7%	917,999	4,480,551	
LA 510	12.08	70.6%	23.3%	5,020,353		

EXHIBIT C - TELEPHONE LOAN BORROWERS IN STRONG FINANCIAL CONDITION AS OF DECEMBER 31, 1997

BORROWER	TIER	NET WORTH TO TOTAL ASSETS	TOTAL LONG-TERM DEBT TO EQUITY	LONG-TERM DEBT		
				RUS	RTB	FFB
LA 511	24.62	77.4%	8.7%		1,926,780	
LA 515*	13.89	82.8%	13.2%	1,287,747	3,263,526	
LA 521	7.77	53.6%	43.6%	2,897,107		
LA 522	8.53	70.4%	26.4%	29,724	1,966,128	
LA 527	8.50	63.2%	46.3%	3,188,338		
LA 529	15.07	76.3%	13.6%		1,173,540	3,969,120
LA 530	7.73	67.6%	35.9%		6,549,469	
LA 531	6.80	67.0%	28.0%		5,999,102	
LA 532	16.06	68.3%	28.3%	18,395,574		
LA 533	5.66	60.7%	42.0%		1,983,442	
MA 501*	4.48	52.7%	79.7%	840,702	1,246,586	
ME 518	5.34	52.8%	64.4%	2,582,659	138,666	
ME 524	5.10	59.8%	34.5%	3,489,468	823,658	588,639
ME 525	6.47	52.5%	53.5%	280,441	171,760	
ME 526	6.79	60.0%	42.1%	1,258,018		
ME 529	4.94	58.1%	36.9%	433,421	408,891	
MI 512*	4.48	52.1%	68.1%	2,350,973	787,890	
MI 523	4.41	64.7%	33.6%	1,374,054	1,227,037	
MI 533	4.17	50.1%	93.0%	4,756,428	6,798,263	
MI 548	67.23	79.7%	15.6%	710,249		
MI 551*	5.82	54.3%	63.6%	1,270,667		
MI 556	22.40	78.3%	8.2%	777,162		
MI 558	5.39	61.4%	41.8%	961,111		
MI 561	7.64	57.5%	44.1%	572,503	16,525,963	
MI 564	4.44	56.3%	51.1%	1,810,686	2,346,603	
MI 566	18.93	65.1%	26.2%	3,592,534	220,427	1,036,111
MI 567	7.26	50.5%	78.3%	1,020,028		
MI 568	4.60	48.4%	86.5%	2,320,095		

EXHIBIT C - TELEPHONE LOAN BORROWERS IN STRONG FINANCIAL CONDITION AS OF DECEMBER 31, 1997

BORROWER	TIER	NET WORTH TO TOTAL ASSETS	TOTAL LONG-TERM DEBT TO EQUITY	LONG-TERM DEBT		
				RUS	RTB	FFB
MI 569	4.89	56.1%	52.9%	1,682,899	1,387,419	
MN 501*	5.24	53.2%	78.9%	1,694,333	572,836	
MN 505*	4.24	48.2%	86.7%	12,945,384	2,269,988	
MN 512	37.98	70.8%	15.9%	806,470	119,798	
MN 516	10.17	57.1%	47.2%	724,279		
MN 525	31.58	75.8%	16.1%	4,093,849	964,652	
MN 540*	26.19	65.4%	43.6%	2,560,491	262,597	
MN 541	17.92	82.1%	17.8%	409,577	618,715	
MN 547	6.07	54.0%	50.8%	448,687		
MN 552	12.62	78.0%	9.8%	516,277	816,919	
MN 563*	5.88	54.5%	61.3%	8,109,937	2,369,469	
MN 564*	7.19	47.4%	87.0%	5,773,812	435,596	
MN 565	7.38	58.8%	47.4%	2,671,147		
MN 571*	4.77	50.2%	79.1%	1,217,605		
MN 582*	4.07	47.7%	94.3%	9,259,416	963,162	
MN 583	7.89	58.3%	52.6%	26,971	1,792,358	
MN 585	55.47	88.2%	6.7%	8,831	95,067	
MN 592	5.38	52.4%	80.0%		1,758,709	
MN 599	87.17	92.1%	4.3%	4,267	184,207	
MN 600	7.10	64.1%	32.3%	1,428,736	2,208,098	
MN 603	6.29	51.9%	71.5%	625,073		
MN 605	55.88	68.7%	17.1%	723,757	111,494	
MN 606	38.90	86.5%	8.9%	332,277		
MN 612	9.76	65.4%	22.4%	1,132,000	629,000	
MN 613	4.55	50.3%	59.5%	536,111	4,565,959	
MN 614	7.21	69.6%	21.7%		284,343	
MN 617	19.18	59.3%	45.9%	389,943		
MN 620	12.98	54.0%	57.3%	1,535,080		

EXHIBIT C - TELEPHONE LOAN BORROWERS IN STRONG FINANCIAL CONDITION AS OF DECEMBER 31, 1997

BORROWER	TIER	NET WORTH TO TOTAL ASSETS	TOTAL LONG-TERM DEBT TO EQUITY	LONG-TERM DEBT		
				RUS	RTB	FFB
MN 621	4.27	47.2%	73.2%	5,285,175	3,670,973	
MN 622	75.59	86.8%	11.0%	486,376		
MN 623	5.83	46.4%	79.6%	3,402,888	1,028,650	
MN 624	5.15	53.4%	48.9%	1,734,067		
MN 629	7.24	45.6%	75.7%	584,457	1,162,120	
MO 505	21.97	70.7%	34.1%	1,411,309		
MO 534	4.98	56.5%	66.9%	5,440,653		
MO 535	18.55	75.6%	22.8%	1,299,225	727,932	
MO 538*	5.35	58.1%	70.4%	7,100,569		
MO 545*	4.99	66.9%	49.7%	5,447,084		
MO 554	7.19	71.0%	37.1%	5,117,506		
MO 556	6.35	68.2%	25.2%	75,848	762,393	
MO 558	40.69	78.4%	13.7%	2,473,422		
MO 568	18.20	73.7%	21.2%	372,105		
MO 583	5.88	51.4%	57.1%	21,841,813	14,702,292	2,772,437
MO 591	61.97	75.2%	20.4%	1,249,302	169,443	
MO 592	8.43	44.8%	107.0%	2,832,839		
MO 594	241.32	98.0%	1.0%	45,218		
MO 597	218.39	89.2%	3.9%	85,040		
MO 599*	5.42	55.9%	51.8%	719,030		
MO 605	4.81	49.7%	67.1%	1,339,561		
MS 501	12.64	60.5%	35.2%	512,670	209,775	
MS 503	10.98	48.7%	52.6%	1,162,425		2,365,797
MS 504	5.68	63.6%	39.8%	222,656	3,066,944	
MS 505	25.63	73.1%	7.4%	114,942		
MS 506	6.48	54.7%	47.8%	9,751,521		
MS 536	4.97	62.6%	47.4%	5,948,103	1,262,968	
MT 511	7.24	57.6%	67.2%	8,504,452		

EXHIBIT C - TELEPHONE LOAN BORROWERS IN STRONG FINANCIAL CONDITION AS OF DECEMBER 31, 1997

BORROWER	TIER	NET WORTH TO TOTAL ASSETS	TOTAL LONG-TERM DEBT TO EQUITY	LONG-TERM DEBT		
				RUS	RTB	FFB
MT 512*	5.26	47.3%	96.0%	25,617,276		
MT 516	4.36	61.7%	52.9%	16,888,181		
MT 517*	4.01	60.3%	50.4%	7,761,759		
MT 518	8.77	62.4%	50.6%	12,908,492		
MT 525	13.97	54.5%	55.8%	632,012	165,784	
MT 526	7.65	48.1%	73.9%	2,669,591		
NC 509	8.11	59.2%	53.5%	9,221,685	543,175	
NC 510	6.15	46.8%	67.2%	1,565,288	44,403,578	5,538,274
NC 513	15.29	66.5%	33.0%	5,679,058	1,497,563	
NC 518	10.98	61.5%	42.9%	8,468,490		
NC 529	4.12	44.7%	96.4%	3,980,249		
NC 531	4.33	48.1%	87.8%	18,519,351	11,836,715	
NC 534	8.43	63.3%	27.4%	433,696		
NC 535	6.64	59.7%	53.2%	12,811,066		
NC 543	15.05	70.6%	22.6%	445,033		
ND 519*	4.14	50.2%	82.9%	7,792,288		
ND 522	13.11	75.8%	22.0%	3,009,931		
ND 524*	9.24	56.1%	46.8%	12,024,582		
NE 524	9.20	58.0%	41.1%	5,684,957		
NE 525	14.51	76.2%	18.1%	1,733,850		
NE 526	4.16	54.0%	74.5%	4,037,996		
NE 527	8.49	52.2%	18.8%	1,646,336		
NE 529*	8.39	70.1%	16.0%	761,533	778,772	
NE 532	8.51	74.8%	30.0%	2,061,146		
NE 536	5.11	60.6%	24.6%	445,932	1,240,289	
NE 543*	4.07	65.4%	43.2%	1,013,732		
NE 544	6.41	69.1%	37.7%	1,621,139		
NE 547	7.94	63.5%	27.2%	2,094,435		

EXHIBIT C - TELEPHONE LOAN BORROWERS IN STRONG FINANCIAL CONDITION AS OF DECEMBER 31, 1997

BORROWER	TIER	NET WORTH TO TOTAL ASSETS	TOTAL LONG-TERM DEBT TO EQUITY	LONG-TERM DEBT		
				RUS	RTB	FFB
NE 548	7.12	56.5%	68.9%	1,130,743		
NE 555	36.31	91.4%	3.8%	141,573		
NE 560	15.20	65.2%	37.4%	552,424	210,047	
NE 561	6.68	67.9%	34.3%	2,044,067		
NE 563	10.45	57.4%	33.7%	2,179,618		
NE 565	5.05	63.0%	53.1%	2,901,989	537,412	
NE 566	6.20	59.5%	37.9%	1,403,985		2,943,527
NE 567	6.23	50.6%	87.5%	1,748,705		
NE 569	32.87	91.6%	7.0%	756,900		
NE 570	4.82	60.5%	40.5%	1,787,903		
NE 571	7.71	64.6%	48.6%	2,406,806	488,501	
NH 504	7.31	67.6%	23.3%	168,113	1,801,550	
NH 507	5.97	72.9%	22.6%	40,046	214,274	
NH 510	5.71	61.5%	49.4%	1,500,618		
NJ 504	6.51	46.0%	39.7%	602,870		
NM 501*	8.20	63.0%	46.3%	4,566,058		
NV 502	40.55	84.5%	3.8%	81,351	140,244	
NV 503	4.22	54.7%	57.6%	7,492	4,689,460	
NY 501	10.82	59.0%	17.6%	163,841	69,482	
NY 512*	6.09	71.4%	14.4%	421,564	1,610,999	
NY 533	5.26	64.1%	26.6%	240,452		
NY 537	5.24	67.4%	22.3%	1,123,736		
NY 540	4.25	56.1%	50.7%	1,046,617	1,079,809	
NY 543	5.36	64.6%	26.8%		1,948,737	
NY 550	9.03	51.2%	34.4%		1,924,970	
NY 552	5.26	61.1%	29.0%	316,219		
OH 503	22.21	79.2%	21.9%	539,354		
OH 504	8.39	72.5%	27.7%	1,521,814		

EXHIBIT C - TELEPHONE LOAN BORROWERS IN STRONG FINANCIAL CONDITION AS OF DECEMBER 31, 1997

BORROWER	TIER	NET WORTH TO TOTAL ASSETS	TOTAL LONG-TERM DEBT TO EQUITY	LONG-TERM DEBT		
				RUS	RTB	FFB
OH 510	4.21	60.8%	55.9%	1,094,107		
OH 512	4.20	55.0%	50.5%	893,664		
OH 513	6.34	45.8%	100.3%	1,202,499		
OH 521	24.37	78.5%	20.8%	217,904		
OH 524	5.43	74.3%	20.6%		320,093	
OH 526	16.86	86.4%	7.5%	158,171		
OH 529	8.69	66.2%	45.6%	532,396		
OH 530	8.42	67.1%	30.3%	849,777	776,840	
OK 517	37.61	81.5%	13.0%	566,750		
OK 518	5.07	70.7%	18.7%	397,389	485,659	
OK 534*	4.12	46.4%	92.9%	5,097,008		
OK 536	8.63	49.0%	74.3%	931,091		
OK 538	9.75	75.9%	22.0%	256,819		
OK 543	12.37	64.3%	18.1%	339,905	1,477,322	
OK 549	7.57	61.7%	52.3%	126,898		
OK 555	7.20	51.4%	67.6%	7,166,276		
OK 558	11.92	61.0%	37.9%	1,005,210		
OK 559	5.78	52.3%	53.6%	5,256,685	8,303,671	1,793,273
OK 560	5.30	59.5%	51.7%	190,145	1,597,201	
OK 563	5.82	70.8%	27.2%	11,746,251		
OK 565	6.47	47.6%	63.5%		9,127,400	
OR 510*	4.46	54.2%	68.8%	1,676,324	826,458	
OR 522*	18.81	77.9%	8.9%	1,189,608	840,889	
OR 525	4.83	69.2%	22.0%	157,429	2,667,191	
OR 540	8.50	69.0%	34.9%	773,259		
OR 544	11.18	68.4%	38.7%		837,227	
OR 548	10.00	58.3%	57.3%	905,327		
PA 522	8.44	62.9%	23.9%	1,502,181		

EXHIBIT C - TELEPHONE LOAN BORROWERS IN STRONG FINANCIAL CONDITION AS OF DECEMBER 31, 1997

BORROWER	TIER	NET WORTH TO TOTAL ASSETS	TOTAL LONG-TERM DEBT TO EQUITY	LONG-TERM DEBT		
				RUS	RTB	FFB
PA 525	13.14	79.1%	14.5%	883,982		
PA 536	5.34	63.3%	42.0%	905,103		
PA 547	13.96	59.5%	34.4%	335,632	595,333	
PA 552	5.23	49.8%	46.2%	805,856	164,720	
PA 553	8.44	49.1%	55.9%		20,133,762	6,903,000
PA 564	5.84	50.0%	47.3%	2,859,347	10,892,745	5,371,494
SC 505	5.06	50.0%	56.8%	335,763	11,796,594	5,092,430
SC 506	24.32	82.4%	16.5%	3,323,745		
SC 508	6.76	60.2%	47.2%	652,673	2,505,625	
SC 512	4.04	63.1%	43.8%	1,920,285	6,471,884	
SC 522	33.09	89.2%	6.6%		1,622,614	
SC 525	5.05	63.7%	44.3%	411,874	3,193,583	
SC 526	10.33	69.3%	20.5%	1,368,110	4,121,839	
SC 535	9.70	69.2%	35.2%	1,995,768		
SC 538	11.74	76.7%	13.5%	156,684	2,584,350	
SD 508*	6.66	47.3%	84.8%	22,297,394	901,843	
SD 523	8.50	58.0%	64.2%	2,036,488		
SD 526	11.03	69.2%	33.8%	616,904	2,404,190	
SD 538*	5.00	52.1%	83.5%	11,209,627		
TN 510	6.80	60.9%	33.8%	17,451,776		
TN 517	4.32	47.5%	48.8%	3,817,991		
TN 525	7.77	66.7%	23.3%	184,652	3,761,642	
TN 530	14.83	54.8%	72.3%	16,884,183	6,571,449	
TN 547	8.29	67.0%	38.4%	14,900,053	1,424,845	
TN 548*	4.61	57.7%	65.5%	4,795,451	5,388,990	
TN 555	104.96	70.5%	3.1%	153,766		
TN 560	120.26	76.6%	1.0%	60,929		
TX 506	5.38	64.1%	39.8%	2,378,912		

EXHIBIT C - TELEPHONE LOAN BORROWERS IN STRONG FINANCIAL CONDITION AS OF DECEMBER 31, 1997

BORROWER	TIER	NET WORTH TO TOTAL ASSETS	TOTAL LONG-TERM DEBT TO EQUITY	LONG-TERM DEBT		
				RUS	RTB	FFB
TX 510	10.80	68.1%	28.1%	17,251,268		
TX 517	18.25	67.5%	38.1%	5,113,654		
TX 522	43.15	91.5%	4.7%	575,175		
TX 528	14.91	95.1%	-0.7%	(102,590)		
TX 544	4.53	58.2%	61.2%	10,821,088	812,783	
TX 549**	5.06	51.8%	81.6%	27,222,489		
TX 558	12.68	70.5%	34.6%	5,199,796		
TX 559*	6.76	60.4%	60.9%	4,805,205		
TX 562*	6.58	63.1%	52.4%	25,194,322		
TX 567	7.71	47.9%	95.6%	6,418,464		
TX 572	6.19	51.7%	70.8%	5,861,791	5,132,461	
TX 573	9.61	74.7%	24.3%	2,710,445	13,978,357	
TX 604	10.63	65.4%	12.4%	1,344,626		
TX 624	6.55	66.8%	40.6%	5,706,001		
TX 630**	4.87	50.4%	81.8%	18,563,976	2,393,991	
TX 633*	5.20	55.9%	59.0%	2,508,337	733,446	
TX 635*	36.36	72.9%	28.1%	2,133,215		
TX 637	29.48	76.0%	24.4%	330,471	335,206	
TX 638	6.66	60.5%	50.2%	1,251,169		
UT 504	13.12	69.0%	34.7%	3,782,211		
VA 511	8.96	66.7%	37.7%	904,909		
VA 517	12.22	57.4%	41.9%	421,403	10,319,965	
VA 521	5.28	58.0%	50.0%	1,522,267	3,003,446	
VA 522	35.81	89.5%	4.5%	77,023		
VA 523	15.98	86.6%	10.6%		552,333	
VA 525	11.65	45.7%	70.6%	3,646,500	4,629,555	
VA 526	6.86	65.1%	34.8%	1,522,617		694,386
VA 530	6.19	78.9%	13.6%	935,570		

EXHIBIT C - TELEPHONE LOAN BORROWERS IN STRONG FINANCIAL CONDITION AS OF DECEMBER 31, 1997

BORROWER	TIER	NET WORTH TO TOTAL ASSETS	TOTAL LONG-TERM DEBT TO EQUITY	LONG-TERM DEBT		
				RUS	RTB	FFB
VT 504	7.97	63.1%	29.4%	11,268	242,348	
VT 505	6.02	61.7%	28.3%		854,644	
VT 507	4.94	60.9%	20.0%	692,028		
WA 526	9.39	55.1%	55.1%	1,766,231		
WA 533	23.85	85.5%	9.0%	194,010		
WA 534	5.73	60.0%	46.3%	3,091,969	656,356	
WA 537	15.46	70.1%	20.7%	222,360	726,566	
WA 539	10.25	62.6%	46.2%	2,244,083		
WA 540	9.76	53.8%	37.2%	1,179,507	2,888,361	
WI 501	13.19	67.0%	29.0%	544,862		
WI 507	35.47	89.0%	5.9%	16,894	189,556	
WI 519	148.54	75.3%	23.9%	258,226	312,723	
WI 523	93.26	79.7%	5.1%	181,604		
WI 534	7.03	60.6%	60.6%	2,189,538		
WI 536	5.09	46.2%	58.2%	803,551	2,667,666	
WI 540	39.32	74.6%	15.5%	304,115		
WI 562*	4.29	48.2%	95.1%	301,200	1,044,085	
WI 569	4.38	55.7%	35.0%	731,095	417,088	
WI 572	4.44	68.2%	24.0%	10,000,975	20,548,900	9,894,536
WI 573	6.00	53.5%	56.5%	864,966		
WI 578	4.27	48.9%	43.4%	907,372	16,770	
WI 579*	4.49	59.2%	19.2%	477,207	595,036	
WI 581	8.24	49.4%	68.6%	143,329	2,009,255	
WI 582	5.88	59.5%	26.2%	12,432	2,623,247	
WI 588	5.01	58.0%	32.7%	199,179	1,916,499	
WI 596*	4.13	56.0%	64.7%	2,171,839		
WI 598	9.22	52.9%	64.7%	1,182,397	272,049	
WI 602	12.30	64.8%	28.1%	306,889	1,903,472	

EXHIBIT C - TELEPHONE LOAN BORROWERS IN STRONG FINANCIAL CONDITION AS OF DECEMBER 31, 1997

BORROWER	TIER	NET WORTH TO TOTAL ASSETS	TOTAL LONG-TERM DEBT TO EQUITY	LONG-TERM DEBT		
				RUS	**RTB**	**FFB**
WI 604	6.81	63.3%	22.9%	100,008	409,404	
WI 605	129.55	71.7%	10.4%	372,129		
WI 606	17.28	73.7%	16.8%	118,696	134,592	
WI 610	4.71	68.3%	30.7%		2,918,672	
WI 622	27.62	60.5%	35.5%	1,016,509		
WI 626	4.61	55.3%	65.2%	1,071,997	761,295	
WI 631	4.57	57.8%	54.4%	878,942	2,926,510	
WI 632	4.08	49.6%	73.3%	2,265,563		
WI 633	4.39	51.8%	75.9%	3,275,610	1,481,991	
WI 634	8.62	65.4%	42.8%	2,309,927		
WI 639	5.19	59.8%	54.3%	3,918,169		
WV 522	4.39	69.9%	26.1%	15,039,141	628,538	
WY 514	6.24	67.7%	35.4%	135,293	1,272,514	
NMI 501	5.18	51.2%	75.6%	8,844,811	28,453,077	
TOTAL NUMBER OF BORROWERS	**434**	**TOTALS**		**$1,193,234,230**	**$595,514,322**	**$85,828,645**
		GRAND TOTAL - RUS/RTB/FFB DEBT		**$1,874,577,197**		

*Received telephone loan(s) during FY 1995 through FY 1999 as of August 31, 1999.

**Received telephone loan(s) in more than one fiscal year during FY 1995 through FY 1999 as of August 31, 1999.

EXHIBIT D - LOAN APPLICATIONS CARRIED OVER TO NEXT FISCAL YEAR DUE TO LACK OF AVAILABLE FUNDING

APPLICATIONS CARRIED OVER	BORROWER ID	LOAN AMOUNTS (APPROVED)			HOLDOVER REASON NOTES
		HARDSHIP	COST OF MONEY	RTB	
FY 95 to FY 96:	IN 506 1/		$3,279,000	$1,913,100	5/
	TX 578 1/	$7,000,000	1,634,000	953,400	6/
	WI 584 1/		2,529,000	1,476,300	5/
Subtotal		$7,000,000	$7,442,000	$4,342,800	
FY 96 to FY 97:	MN 618 1/	$ 2,425,000			7/
	SD 517 1/	5,226,000			7/
	WI 625 1/	4,492,000			7/
	OK 566 1/	7,000,000	$ 544,000	$ 319,200	7/
	MN 555 1/3/	7,000,000	321,000	187,950	7/
	SD 537 1/	6,752,000			7/
	WY 519 1/	7,000,000	2,682,000	1,577,100	7/
	MN 564 2/	7,000,000	5,366,000	3,155,250	7/
Subtotal		$46,895,000	$8,913,000	$5,239,500	
FY 97 to FY 98:	MN 555 1/	$ 7,000,000	$ 321,000	$ 187,950	7/
	MN 540 2/4/	5,000,000	5,928,000	3,112,200	7/
	SD 525 1/	7,000,000	299,000	174,300	7/
	ND 519 2/	4,013,000			7/
	MN 589 1/	5,130,000			7/
	SD 509 1/	7,000,000	3,793,000	2,212,350	7/
	SD 524 1/	7,000,000	1,804,000	1,052,100	7/
	KS 593 1/	7,000,000	2,829,000	1,649,550	7/
	IA 656 2/	1,784,000			7/
	ND 521 1/	7,000,000	5,490,000	3,202,500	7/
Subtotal		$57,927,000	$20,464,000	$11,590,950	

EXHIBIT D - LOAN APPLICATIONS CARRIED OVER TO NEXT FISCAL YEAR DUE TO LACK OF AVAILABLE FUNDING

APPLICATIONS CARRIED OVER	BORROWER ID	LOAN AMOUNTS (APPROVED)			HOLDOVER REASON NOTES
		HARDSHIP	COST OF MONEY	RTB	
FY 98 to FY 99:	MN 540 2/	$ 5,000,000	$ 5,928,000	$ 3,112,200	7/
	SD 539 1/	5,000,000	2,027,000	1,063,650	7/
	SD 533 1/	5,000,000	977,000	512,400	7/
	MN 501 2/	4,995,000			7/
Subtotal	ND 536 1/	3,132,000			7/
	IL 513 2/		6,406,000	3,363,150	5/
	KS 591 1/	3,465,000			7/
		$ 26,592,000	$15,338,000	8,051,400	
UNDUPLICATED TOTAL		**$126,414,000**	**$45,908,000**	**$25,924,500**	

1/Not included in OIG-determined "financially strong" borrowers listed in Exhibit C.

2/Included in OIG-determined "financially strong" borrowers listed in Exhibit C.

3/Carried over from FY 96 and FY 97.

4/Carried over from FY 97 and FY 98.

5/Lack of funds in Cost of Money and RTB Authority.

6/Lack of funds in Hardship, Cost of Money and RTB Authority.

7/Lack of funds in Hardship Authority.

EXHIBIT E - SUMMARY OF AGED TELEPHONE LOAN OBLIGATIONS *(Loans made more than 5 years prior to 01/01/99)*

LAST ADVANCE (IN YEARS) FROM 1/1/99 (Note 1)	RURAL UTILITIES SERVICE		RURAL TELEPHONE BANK	
	NUMBER OF LOANS	UNADVANCED LOAN FUNDS (Note 2)	NUMBER OF LOANS	UNADVANCED LOAN FUNDS (Note 2)
> 1 <= 2	41	$94,378,354	19	$37,246,631
> 2 <= 3	44	53,976,555	27	44,977,807
> 3 <= 4	18	13,671,230	17	21,913,612
> 4 <= 5	31	22,274,169	7	3,266,507
> 5 <= 6	16	41,835,357	7	16,549,425
> 6 <= 7	8	3,043,355	9	14,297,438
> 7 <= 8	20	14,602,889	4	2,454,408
> 8 <= 9	10	11,401,928	9	6,160,579
> 9 <= 10	17	6,218,582	6	13,581,100
> 10	36	12,985,669	11	4,073,181
TOTAL FOR BORROWERS WITH LOAN ADVANCES	**241**	**$274,388,088**	**116**	**$164,520,688**
TOTAL FOR BORROWERS WITH LOANS APPROVED BUT NO FUNDS ADVANCED IN 5 YEARS	**16**	**$44,701,000**	**36**	**$118,651,050**
GRAND TOTAL - RUS AND RTB LOANS WITH UNUSED BALANCES			**409**	**$602,260,826**

NOTE 1: "> 1 <= 2" means greater than 1 and less than or equal to 2 years, etc.; "> 10" means greater than 10 years.

NOTE 2: Figures include loans made more than 5 years prior to January 1, 1999, but do not include loans that have never had funds advanced and do not include loans not under a loan note.

EXHIBIT F - RUS WRITTEN RESPONSE TO THE DRAFT REPORT

USDA

United States Department of Agriculture
Rural Development

Rural Business–Cooperative Service • Rural Housing Service • Rural Utilities Service
Washington, DC 20250

January 24, 2000

Mr. John O. Leavy
Regional Inspector General
USDA Office of Inspector General
101 South Main Street, Room 324
Temple, Texas 76501

Dear Mr. Leavy:

We appreciate the opportunity to review and comment on the draft Office of Inspector General (OIG) Report No. 09016-1-Te, Telephone Loan Program Policies and Procedures. The report sets forth four recommendations concerning loan program graduation and deobligation of loan funds. Rather than improving efficiencies, the recommendations are in conflict with the clear intent of the United States Congress that rural telecommunications subscribers be afforded the same economic, educational, and health care opportunities as urban and suburban residents. The Rural Utilities Service (RUS) is more than a lender. Participation in the RUS program brings with it requirements for enhanced telecommunications standards and capacity. A mandatory graduation process would not only hold rural subscribers hostage to inferior telecommunications service, it could result in many rural Americans becoming the economic "have-nots" of the 21st Century. This result is contrary to the clear policies established by Congress in the Rural Electrification Restructuring Act (RELRA) of 1993 and the Telecommunications Act of 1996 as well as RUS' annual appropriations language.

Recommendation No. 1:

Work with Congress to clarify RUS' policy for the telephone loan program regarding loan graduation and requiring financially strong borrowers to obtain credit from commercial sources.

RUS Response:

Not only is it inappropriate for RUS personnel to lobby Congress either in support of full program funding or in support of commercial graduation, it is unnecessary. Since the enactment of the RUS Telecommunications Program on October 28, 1949, Congress has, through legislation amending the Rural Electrification Act of 1936 (RE Act), continually perfected and redefined the program's mission to meet the ever-changing needs of rural telecommunications subscribers. Congress has not permitted the

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Telecommunications Program to operate in a vacuum, as implied by this recommendation. Rather, it has ensured that RUS-financed systems provide state-of-the art telecommunications services thereby enabling rural subscribers the same economic, educational, and health care opportunities as urban and suburban residents.

Most recently, Congress reaffirmed its commitment to the citizens of rural America and the role of the Telecommunications Program by increasing funding for the Rural Telephone Bank from the $157,000,000 proposed in the President's 2000 budget to $175,000,000. Various Congressmen and Senators, evidencing bi-partisan support for the program, wrote the chairmen of the Agriculture appropriations committees in support of the increased funding. Clearly, this support demonstrates that Congress is critically aware of the need for RUS financing in rural areas and the value of RUS loan program participation and does not consider loan graduation prudent in today's dynamically telecommunications industry. Never, in the history of our country, has this nation's economy and the global economy been so dramatically influenced by and dependent upon telecommunications technologies and services. It is important to note that Congress reinforced RUS' role by increasing Telecommunications Program financing after receiving the General Accounting Office's Report dated January 1998 entitled "Rural Utilities Service – Opportunities to Operate Electricity and Telecommunications Loan Programs More Effectively" which recommended loan program graduation.

Congress has recently reinforced RUS' role in ensuring that modern, affordable telecommunications service be provided in all rural areas.

Through recent legislative mandates, Congress has reinforced the objective of the Rural Electrification Act of 1936 to fully utilize appropriated loan funds to provide modern, affordable telecommunications service in all rural areas. Specifically, the passage of RELRA mandated new service standards (through State telecommunications modernization plans) for RUS borrowers and strengthened RUS' authority to utilize all funding available to it for the benefit of rural America. RELRA, through revisions to section 305(d) of the RE Act, only permits RUS to lend hardship, cost-of-money, and Rural Telephone Bank (RTB) funds to borrowers participating in a state telecommunications modernization plan thereby ensuring that RUS funding will only be utilized to provide state-of-the art telecommunications infrastructure. Such facilities must be able to provide high-speed Internet access to rural subscribers, as well as Emergency 911 service, caller identification, and capabilities for distance learning and telemedicine applications. RELRA not only includes requirements for borrower financial strength, but also focuses upon the characteristics of the rural areas in which RUS loan funds will be directed, and the types of service that will be required to be provided to these areas. RELRA also requires a borrower's average system density (number of subscribers per mile of cable) to be within a certain range, which assures that the borrower serves predominately rural and high-cost to serve areas. It is important to note that RELRA mandated that cost-of-money loans be made concurrently with RTB loans. Had Congress intended for borrowers to seek concurrent or supplemental funding from nongovernment sources, it would have amended RELRA accordingly. Rather, Congress specifically identified the RTB as the appropriate supplemental lender. It is difficult to read Section 305(d) of the RE Act without concluding that

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Congress is more concerned with the *characteristics of the areas served by RUS borrowers (high cost to serve area) and the types of services provided in those areas than the financial strength of the RUS borrowers* themselves.

Congress clearly acknowledges that the benefits of RUS financing go well beyond low cost capital. When rural telecommunications carriers borrow from RUS, they must purchase high quality materials and equipment and provide the same high quality service to all customers within their service territories. They cannot charge unreasonable service premiums or connection fees to their most rural subscribers and their systems must be able to evolve so that new services and features can be provided to any customer at affordable rates. When rural carriers borrower from commercial lenders, the quality of service standards set by RUS - those necessary to provide service parity between rural and urban areas - do not apply. Commercial lenders do not necessarily require the purchase of new and modern materials and equipment; they do not require that the resulting services be made available to all customers; they do not restrict distance premiums for service or connection fees; and they do not have requirements regarding the modernization capabilities of plant.

Telecommunications parity between rural and urban America is at a greater risk today than any other time in this nation's history. The "lockout" of borrowers through a graduation process would only be detrimental to the Congressionally-mandated national telecommunications policy framework.

In February 1996, President Clinton signed the Telecommunications Act of 1996 into law thereby deregulating local telephone service and replacing a monopolistic industry with a competitive marketplace. Such change promises to bring new carriers into the profitable telecommunications markets including America's cities and larger towns, with the intended and probable result of competitive pricing and innovation. Rural areas are not likely to attract such competition. If they do, new entrants are likely to target the low-cost, high-profit subscribers such as industrial, commercial and in-town residential customers. The rural, high-cost-to-serve customers are unlikely to benefit from competition with their local exchange carriers (LECs) left to cope with rising per-customer costs and decreasing per-customer revenues.

Further complicating this transition is the Telecommunications Act requirement for Federal and state regulators to reform the decades old revenue sharing mechanisms designed by the Bell System to ensure affordable universal service to all subscribers, rural and urban alike. This replacement mechanism is currently being implemented for large LECs. Preliminary results indicate that many states that received high cost support in the past from the Federal fund will be omitted from this new fund. (The Federal mechanism for rural LECs is under consideration later this year.) The Federal Communications Commission (FCC) also made a change in the universal service mechanism for large LECs that unfortunately breaks the link between rural support and actual rural investment. Large LECs that invest the additional capital necessary to serve high-cost areas will not necessarily be compensated for their investments. This change, alone, eliminates a significant historic incentive to invest in rural telecommunications plant. For these large companies, universal service support will be determined by a forward-looking cost proxy model that is indifferent to actual investment.

These challenges to rural telecommunications service come at a time when the nation and the world is becoming increasingly dependent upon the telecommunications network as an economic, social, and educational resource via the Internet and distance learning and telemedicine applications.

When the Congress stated its intent for plant modernization in RELRA, it showed great foresight. In RELRA, Congress required that all plant built with RUS hardship, cost-of-money, and Rural Telephone Bank funds be capable of evolving into broadband capability. RUS has, therefore, been financing such plant since 1995. Congress has, therefore, ensured the portion of rural America served by RUS-financed LECs with access to broadband services. While the accomplishments and progress in providing the benefits of the information age, delivered through advanced telecommunications technologies, is impressive, the work has just begun.

The chasm between those "on-line" and those "off line" still persists and, for rural areas, is even wider and more difficult to overcome when one considers the additional barriers of time and distance. Rural citizens considered among the least connected of all individuals. For instance, the rural poor have the lowest telephone penetration rates, the lowest PC ownership rates, and the lowest on-line access rates. Many rural areas have no service at all. It is estimated that 32 percent of the country's 6.3 million unserved households are in rural areas. This represents nearly 6 million rural residents. Creating opportunities for investment in these areas will be a formidable task. Companies must be willing to make the necessary infrastructure improvements which will require substantial capital investments. Private capital will support much of this investment in lucrative, high-usage markets. However, where no competition exists, telecommunications providers will need assurances that their investments will be supported through universal service initiatives. The lower population density of America's rural areas almost automatically creates a disincentive for companies to make investment in telecommunications plant upgrades.

The sell-off of rural exchanges by large LECs only adds to the rural infrastructure investment problem. Since 1994, one large company has sold off 574 rural exchanges across 14 states. Another, in 1998, announced plans to sell 1.6 million customer lines in rural areas such as Alaska, Arkansas, Oklahoma, and Nebraska. This sell-off allows these companies to "reposition" themselves for competition in the lucrative urban and suburban markets. RUS will likely finance the modernization of these exchanges. For America's rural economies to universally share in the opportunities created by an advanced, seamless telecommunications network, new investment must occur in the rural marketplace.

The analysis of financial strength presented in OIG's report is misleading.

On the whole, RUS telecommunications borrowers today enjoy a relatively stable financial condition. As noted in the audit, average Times Interest Earned Ratios (TIER)

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and equity ratios are good. However, as noted above, the nature of the telecommunications industry is rapidly changing, both from a technological standpoint and an operational standpoint. Today, the telecommunications industry is more capital intensive than ever before. New investment for new technologies and services is required at an increasing rate and private capital providers will seek the most secure investment opportunities in urban or suburban areas, leaving rural areas behind. RUS financing is an important component of the "Universal Service" equation and provides the capital necessary to ensure that rural areas receive the same service offerings as their urban counterparts.

RUS is not a bank of last resort bank for beleaguered rural utilities. It is a rural economic development stimulator that utilizes attractive financing as a tool to encourage rural utilities to build modern telecommunications plant and provide high-quality service to all who work or reside within their assigned territories. The primary objective of the Telecommunications Program, as defined by Congress, is to ensure that rural subscribers have modern, reliable utility service so that they can work, learn, and live like their urban and suburban counterparts. The very success of the RUS program is built, in part, on the financial stability of its borrowers. RUS is proud that, in its 50 years of service, not one telecommunications borrower has defaulted on a loan.

The information provided by OIG in its report is, however, somewhat misleading as to the strength of RUS' borrowers and their ability to raise capital from private lenders. For example, OIG stated that the strongest group of RUS borrowers, measured using a comparison to borrowers that had "self-graduated", or repaid their loans in full, had average interest coverage ratios (or TIERs) of 6.27, or four times the level of 1.5 required by a private lender (based on annual financial data as of December 31, 1997). It is important to note that TIER requirements for obtaining new financing are based upon projected financial performance that includes both the new debt and interest expense, not on current financial performance. An analysis of the 128 RUS borrowers that actually received loans during fiscal years 1997, 1998, and 1999 paints a very different financial picture. The average projected TIER was 1.91. The median was 1.67. Nearly 44 percent had projected TIERs of less than 1.5 and 81 percent had projected TIERs less than 2.5. These projections were based upon RUS' more favorable interest rates - rates as low as 5 percent. TIER projections made at private market rates for these same borrowers would have been substantially lower.

Recommendation No. 2:

If Congress determines that RUS should graduate financially strong borrowers to commercial credit sources and require financially strong borrowers to obtain credit from other sources, RUS should develop a strategy to:

- Submit annual appropriation requests for telephone program loan funds based on anticipated assistance to borrowers who are unable to finance their credit needs internally or from non-Government sources.
- Require borrowers to have been denied commercial credit as a condition for RUS financial assistance.

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- Establish a graduation program to assist financially strong borrowers to refinance their outstanding direct loans to other credit sources.
- Evaluate the financial condition of all borrowers and require those borrowers in strong financial condition to graduate their outstanding direct loan balances to other credit sources including the borrowers cited in Exhibit C with loans totaling $1.87 billion).

RUS Response:

Through enactment of RELRA and the Telecommunications Act of 1996 and through continued funding support, Congress has demonstrated that it is not its intent to require financially strong borrowers to obtain credit from other sources (See response to Recommendation No. 1). To do so would be contrary to the purpose and operation of RELRA. Therefore, it is unnecessary for RUS to develop the strategy detailed in Recommendation No. 2.

Recommendations No. 3 and No. 4

Implement procedures to evaluate telephone loans, at least annually, to determine if the purposes for which the loans were made have been accomplished and deobligate all funds that are not needed.

Review the RUS and RTB loans made over 5 years ago and determine how much of the cited $602,260,826 in unadvanced funds should be deobligated.

RUS Response:

As these two recommendations are interrelated, RUS will address them simultaneously.

In a report issued by OIG in June 1985, Report No. 09614-2-Te, "Rural Electrification Administration - Telephone Loan Making Policies," OIG recommended that a thorough analysis be performed of all borrowers with unadvanced loan funds over 6 years old and that all unneeded loan funds be deobligated.

In response to this recommendation, the Rural Electrification Administration, now RUS, issued a proposed rule dated August 24, 1988. In that proposed rule, RUS addressed the automatic rescission of loans after 6 years and, in fact, shortened the period to 5 years. Specifically, the proposed revision as set forth in the August 24, 1988, edition of the Federal Register (Vol. 53, No. 164) in Section 1745.42, Automatic rescission, stated in part:

(a) Loans approved after [Insert the effective date of this CFR Part] will include a contract provision that all loan funds not encumbered 5 years after the date of a note representing those loan funds will be automatically rescinded and the Government's obligation to advance those funds will be terminated. Funds are encumbered when they have been approved for advance by REA for a particular loan purpose.

(b) The Administrator may agree to an extension of the obligation of the Government to advance unencumbered funds if the borrower demonstrates to

> the satisfaction of the Administrator that the loan funds not encumbered will be needed for approval (sic) loan purposes. To apply for an extension . . .

RUS received comments on the proposed rule from 37 members of Congress, 7 telephone industry trade associations, 68 borrowers, and 2 other interested parties. The majority of commenters objected to the automatic rescission provisions of §1745.42. Based primarily upon the objections of Congress, RUS amended its final rule to allow for advances to be extended past the 5-year period (currently 6 years) provided for in a borrower's note.

In response to RUS' proposal to deobligate funds, Congress further emphasized the importance it placed on this issue in Section 2357 of the Rural Economic Development Act of 1990, title XXIII of the Farm Bill, Public Law 101-624, enacted on November 28, 1990. This law added section 206 to the RE Act of 1936 which states, in part:

> The Administrator and the Governor of the telephone bank shall not . . . rescind an insured telephone loan, or a Rural Telephone Bank loan, made under this Act without the consent of the borrower, ***unless all of the purposes for which telephone loans have been made to the borrower under this Act have been accomplished with funds provided under this Act. . . .*** [emphasis added]

This section of the Act remains in effect today. Because of the improbability of ever making the legislatively-mandated determination that all of the purposes for which telephone loans have been made to the borrower under this Act have been accomplished, RUS has not developed procedures to unilaterally deobligate loan funds. RUS has, however, on an ongoing basis, evaluated telecommunications loans to determine if the purposes for which the loans were made have been accomplished. Furthermore, RUS has rescinded (deobligated) those funds that are no longer needed when authorized to do so; that is, with the consent of the borrower.

In the last 3 fiscal years, RUS has rescinded (deobligated) nearly $320 million, as follows:

FY 1999	$133,801,528	involving 26 borrowers and 34 loans
FY 1998	$ 59,271,800	involving 25 borrowers and 42 loans
FY 1997	$124,947,218	involving 24 borrowers and 32 loans

On a routine basis, RUS notifies those borrowers that have exceeded, or are about to exceed, their note basis period (usually 6 years), that funds remain unexpended. At this time, RUS asks if all, or a portion, of the unadvanced loan funds could be rescinded if they are no longer needed. Alternatively, RUS offers to prepare a new basis date agreement (usually for 3 years) if the borrower justifies the need for these funds. When the borrower provides the information required by 7 CFR 1735.47(a), RUS processes a rescission recommendation and deobligates the funds accordingly.

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The Telecommunications Program also monitors those borrowers under the new form of note which doesn't restrict advances after the end of a certain number of years. Again, RUS follows up with letters determine if unadvanced loan funds may be rescinded. The Telecommunications Program's general field representatives (GFRs) also discuss the need for unadvanced loan funds or the rescission of those funds when they visit their borrowers.

Based upon the procedures detailed above, the Telecommunications Program currently has the necessary measures in place to monitor and deobligate, with borrower concurrence, unadvanced loan funds. However, due to the legislatively mandated requirement for borrower concurrence, it would be improper for RUS to unilaterally deobligate unadvanced funds after a 5-year time period.

Once again, we appreciate the opportunity to review and comment on the draft report. If you wish to discuss these comments on a more detailed basis, we are available at your request. While we welcome suggestions that will improve the operational efficiency of the Telecommunications Program, any recommendations that are forthcoming should take into consideration the revolution that is taking place in the telecommunications industry. Due to the numerous uncertainties surrounding the evolution of this industry, it is important the telecommunications lending program remain flexible in its abilities to provide financing to ensure affordable, modern, reliable telecommunications service to rural America.

Sincerely,

Christopher A. McLean

CHRISTOPHER A. MCLEAN
Acting Administrator