U.S. Department of Agriculture

Office of Inspector General
Financial & IT Operations

Audit Report

Rural Development's Financial Statements for Fiscal Years 2004 and 2003

Report No. 85401-11-FM
November 2004

UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250

DATE: November 5, 2004

REPLY TO
ATTN OF: 85401-11-FM

SUBJECT Rural Development's Financial Statements for Fiscal Years 2004 and 2003

TO: Gilbert Gonzalez
Acting Under Secretary
for Rural Development

ATTN: John M. Purcell
Director
Financial Management Division

This report presents the results of our audit of Rural Development's financial statements for the fiscal years ending September 30, 2004 and 2003. The report contains an unqualified opinion and the results of our assessment of Rural Development's internal control structure and compliance with laws and regulations.

Based on the information provided during the audit, we have reached management decision on Recommendations Nos. 4 and 5 in the report. In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing the corrective actions taken or planned, including the timeframes, on the remaining recommendations. Please note that the regulation requires a management decision to be reached on all findings and recommendations within a maximum of 6 months from report issuance.

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

/s/

ROBERT W. YOUNG
Assistant Inspector General
for Audit

Executive Summary

Rural Development's Financial Statements for Fiscal Years 2004 and 2003 (Audit Report No. 85401-11-FM)

Purpose

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

We conducted our audit at the Rural Development Finance Office and Centralized Servicing Center in St. Louis, Missouri, and the Rural Development National Office in Washington, D.C. We also performed site visits to selected Rural Development field offices.

Results in Brief

In our opinion, the Rural Development consolidated financial statements for fiscal years 2004 and 2003, including the accompanying notes, present fairly in all material respects, the assets, liabilities, and net position of Rural Development, as of September 30, 2004 and 2003; and its net costs, changes in net position, budgetary resources, and reconciliations of net costs to budgetary obligations for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In our "Report on the Internal Control Structure Over Financial Reporting," we reported that improvements are needed in Rural Development's (1) information technology, (2) credit reform processes, and (3) unliquidated obligation process.

In our "Report on Compliance with Laws and Regulations," we continued to note where further actions are necessary relating to improving financial management systems.

Key Recommendations

We recommended Rural Development expand the credit reform checklist and ensure all model changes are thoroughly evaluated. Rural Development should also implement a tracking mechanism to maintain control over the final version of its financial statement package including the credit reform footnote. Further, Rural Development should obtain certification of all unliquidated obligations and implement additional procedures for identifying and deobligating funds not needed.

Agency Position

Rural Development officials generally agreed with the findings and recommendations in this report, except that they did not believe that the "Credit Reform Processes Still Need Improvement" Finding No. 2 constituted a material weakness.

OIG Position

Based on the definition of a material weakness provided on page 7 of this report, we continue to believe that Finding No. 2 is a material internal control weakness.

Abbreviations Used in This Report

DCFO	Office of the Deputy Chief Financial Officer
FFMIA	Federal Financial Management Improvement Act
FFMSR	Federal Financial Management Systems Requirements
ISSPM	Information System Security Program Manager
IT	Information Technology
JFMIP	Joint Financial Management Improvement Program
NIST	National Institute of Standards and Technology
OIG	Office of the Inspector General
OMB	Office of Management and Budget
RULSS	Rural Utilities Loan Servicing System
RUS	Rural Utilities Service

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UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250

Report of the Office of Inspector General

TO: Gilbert Gonzalez
Acting Under Secretary
for Rural Development

We have audited the accompanying consolidated balance sheets of Rural Development as of September 30, 2004 and 2003, and the related consolidated statements of net cost, changes in net position, financing, and the combined statements of budgetary resources (hereinafter referred to as the "consolidated financial statements") for the fiscal years then ended. The consolidated financial statements are the responsibility of Rural Development's management. Our responsibility is to express an opinion on the consolidated financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, "Audit Requirements for Federal Financial Statements." Those standards and OMB Bulletin No. 01-02 require that we plan and perform the audit to obtain reasonable assurance that the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above, present fairly, in all material respects, the financial position of Rural Development as of September 30, 2004 and 2003; and its net costs, changes in net position, reconciliation of net costs to budgetary obligations, and budgetary resources for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The information in Management's Discussion and Analysis is not a required part of the consolidated financial statements, but is supplemental information required by accounting principles generally accepted in the United States of America or OMB Bulletin No. 01-09, "Form and Content of Agency Financial Statements." We have applied certain limited procedures, consisting principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information and, accordingly, we express no opinion on it.

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

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

/s/

ROBERT W. YOUNG
Assistant Inspector General
for Audit

November 5, 2004

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

TO: Gilbert Gonzalez
Acting Under Secretary
for Rural Development

We have audited the accompanying consolidated balance sheets of Rural Development as of September 30, 2004 and 2003, and the related consolidated statements of net cost, changes in net position, financing, and the combined statements of budgetary resources (hereinafter referred to as the "consolidated financial statements"), and have issued our report thereon dated November 5, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, "Audit Requirements for Federal Financial Statements."

In planning and performing our audit, we considered Rural Development's internal control over financial reporting by obtaining an understanding of the internal controls, determining whether the internal controls had been placed in operation, assessing control risk, and performing tests of control in order to determine our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-02 and Government Auditing Standards. We did not test all internal controls as defined by the Federal Managers' Financial Integrity Act of 1982. The objective of our audit was not to provide assurance on Rural Development's internal control. Consequently, we do not provide an opinion on internal control over financial reporting.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation that, in our judgment, could adversely affect the agency's ability to record, process, summarize, and report financial data consistent with the assertions by management in the consolidated financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more internal control components do not reduce to a relatively low level the risk that misstatements, in amounts that would be material in relation to the consolidated financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected.

We noted certain matters described in the "Findings and Recommendations" Sections 1 and 2 involving the internal control over financial reporting and its operation that we consider to be reportable conditions. We believe that the reportable conditions in Section 1 are material weaknesses.

Additional Other Procedures

As required by OMB Bulletin No. 01-02, we considered Rural Development's internal control over required supplemental information by obtaining an understanding of the internal control, determining whether these internal controls had been placed in operation, assessing control risk, and performing tests of controls. Our procedures were not designed to provide assurance on internal control over such required supplemental information; accordingly, we do not provide an opinion on such controls.

As further required by OMB Bulletin No. 01-02, with respect to internal control related to performance measures determined by management to be key and reported in the Management's Discussion and Analysis, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions. Our procedures were not designed to provide assurance on internal control over reported performance measures; accordingly, we do not provide an opinion on such controls.

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

/s/

ROBERT W. YOUNG
Assistant Inspector General
for Audit

November 5, 2004

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

TO: Gilbert Gonzalez
Acting Under Secretary
for Rural Development

We have audited the consolidated balance sheets of Rural Development as of September 30, 2004 and 2003, and the related consolidated statements of net cost, changes in net position, financing, and the combined statement of budgetary resources (hereinafter referred to as the "consolidated financial statements"), and have issued our report thereon dated November 5, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, "Audit Requirements for Federal Financial Statements."

The management of Rural Development is responsible for complying with laws and regulations applicable to it. As part of obtaining reasonable assurance about whether the consolidated financial statements are free of material misstatement, we performed tests of Rural Development's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of the consolidated financial statement amounts, and certain provision of other laws and regulations specified in OMB Bulletin No. 01-02, including certain requirements referred to in the Federal Financial Management Improvement Act of 1996 (FFMIA). We limited our tests of compliance to the provisions described in the preceding sentence and did not test compliance with all laws and regulations applicable to Rural Development. However, providing an opinion on compliance with laws and regulations was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests of compliance disclosed no instances of noncompliance with other laws and regulations discussed in the second paragraph of this report, exclusive of FFMIA, that are required to be reported under Government Auditing Standards and OMB Bulletin No. 01-02. (Refer to "Findings and Recommendations," Section 3, "Substantial Noncompliance with FFMIA Requirements.")

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

/s/

ROBERT W. YOUNG
Assistant Inspector General
for Audit

November 5, 2004

Findings and Recommendations

Section 1. Material Internal Control Structure Weaknesses Over Financial Reporting

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

Finding 1 — Information Technology (IT) Control Weaknesses Impact the Reliability of Financial Data

Rural Development has, throughout the year, taken significant steps to address the material weaknesses we identified in our prior reviews of IT security controls.[1] Those weaknesses included noncompliance with the Office of Management and Budget (OMB) Circular A-130, access controls, vulnerability identification and mitigation, application change controls, and ineffective field office security controls. Despite Rural Development's efforts; however, significant actions are still needed to ensure the integrity of Rural Development's financial data. Our prior audits disclosed material weaknesses in Rural Development's ability to effectively ensure the integrity and confidentiality of its IT resources. One major cause of the material weaknesses, which Rural Development has taken steps to address, is that the Chief Information Officer and Information System Security Program Manager (ISSPM) are not properly aligned within the organizational structure to effectively implement a strong security program. As a result, there is ineffective oversight and management of its IT resources that unnecessarily expose Rural Development's critical loan portfolio data to the risk of disclosure, modification, or deletion. The specific weaknesses we have identified, and that Rural Development continues to address, are discussed below.

[1] Audit Report No. 85099-2-FM, "Security Over Rural Development's Information Technology Resources Needs Improvement," dated August 5, 2002; and Audit Report No. 85099-4-FM, "Review of Rural Development's Information Technology Resources Security," dated March 31, 2004.

OMB Circular A-130 Compliance

Rural Development took significant actions during the fiscal year as part of a Department-wide effort to identify its major applications and general support systems, and to ensure those systems were certified and accredited as required by OMB Circular A-130, Appendix III, "Security of Federal Automated Information Resources." Although its efforts are commendable, Rural Development did not complete this effort for all of its major applications until July 2004. Since our financial audit and report on compliance with laws and regulations covers the entire period under review, we believe this should remain as a material weakness for fiscal year 2004 and as an instance of substantial noncompliance with the Federal Financial Management Improvement Act (FFMIA). It should also be reported as such under the Federal Information Security Management Act.

Access Controls

We reported material weaknesses in Rural Development's ability to effectively control access to its sensitive systems and data. Rural Development had not implemented effective internal controls to ensure that:

- User identifications belonging to former employees are removed in a timely manner;
- users have only the access needed to perform their job functions;
- remote access to Rural Development resources are properly managed and secured; and
- password settings conform to National Institute of Standards and Technology (NIST) guidance.

Rural Development has initiated corrective action to ensure that only authorized users have access to its major applications and general support systems, and that authorized users have access to only those resources needed to perform their job functions. Specifically, Rural Development has:

- Instituted a process to circulate user lists to responsible management officials to verify access to several of its systems;
- implemented a process to obtain, maintain, and verify user authorization and access; and
- begun to review mainframe access rules to ensure that access is effectively limited to critical Rural Development datasets.

Once fully implemented these controls will help ensure adequate access controls within Rural Development's IT structure. However, until such time, Rural Development's critical loan data is at risk of disclosure, modification, or deletion.

Vulnerability, Identification, and Mitigation

Our reports continually identified Rural Development's inability to establish effective controls over identification and mitigation of system and network vulnerabilities. We attributed its inability to address this weakness, in part, to the alignment of the ISSPM within the organization and its decentralized operations. During the fiscal year, Rural Development's management has emphasized the ISSPM's roles and responsibilities and the ISSPM has started to implement a routine scanning and mitigation process. However, until Rural Development's ISSPM can implement this process agency-wide, Rural Development's systems remain unnecessarily vulnerable to exploitation.

Application Change Controls

Rural Development was not following its own policies[2] for identifying, selecting, installing, and modifying software. Further, those same policies did not conform to departmental, NIST, and OMB guidance regarding change controls and segregation of duties. Hence, we were unable to validate that system software changes:

- Received proper authorization;
- were supported by change request documents;
- were properly tested and test results approved; or
- were properly monitored while being moved into the production environment.

Rural Development officials were unable to provide us a reasonable explanation for this internal control weakness, but agreed that they needed to conform to proper change control procedures. As of our current fieldwork, Rural Development has not initiated its plan to conduct a thorough review of its change control process. Until such time as Rural Development completes its review and takes corrective actions on its findings, its change control process remains a material weakness.

Field Office Security

Rural Development had not ensured that all IT security controls are in place at its State and field offices. Our work in selected State and field offices in fiscal years 2003 and 2004 across the country disclosed that Rural Development had not established controls to adequately maintain and test

[2] "Rural Development Application Information Systems Support Handbook," dated May 1997.

contingency plans in all of its offices. Further, in several offices, Rural Development personnel had not maintained system backup tapes a sufficient distance from its main operations to ensure the security of those tapes. As a result, Rural Development cannot be assured its State and field offices can timely recover in the event of a natural disaster or other significant service disruption.

Office of Inspector General (OIG) has made numerous recommendations to address these weaknesses in its prior audit reports. OIG has been working closely with Rural Development officials to ensure that corrective actions are taking place. Therefore, we make no additional recommendations concerning these issues in this report.

Finding 2 Credit Reform Processes Still Need Improvement

In fiscal year 2001, Rural Development overcame longstanding problems in the processes and procedures used to estimate and reestimate the costs of loan subsidies for loans[3] made after fiscal year 1991. However, since fiscal year 2001, changes to Rural Development's credit reform practices and processes have continued to evolve. In order to comply with accelerated financial reporting deadlines, Rural Development revised its approach to perform the reestimates earlier using data prior to fiscal yearend. Furthermore, Rural Development has worked to improve its cash flow models. Additional authoritative guidance continues to be released in the credit reform area.

In fiscal year 2004, OIG identified deficiencies in Rural Development's credit reform processes related primarily to the changes made to use data prior to fiscal yearend and enhancements made to its cash flow models. Rural Development (1) computed its "approximated"[4] reestimates inaccurately, (2) did not properly address cash flow model changes for non-housing direct, and (3) provided inaccurate support and/or disclosure for two of the tables in the credit reform footnote. Furthermore, enhancements made by the contractor for the direct multi-family housing program resulted in overstated disbursements. Additionally, Rural Development needs to improve its trend analysis.[5] The "approximated" errors occurred because Rural Development did not follow procedures to ensure the weighted average interest rate was correct and the second party review performed did not detect the errors. Furthermore, the changes made to the non-housing

[3] New cash flow models were implemented for guaranteed programs in fiscal year 2000 and direct programs in fiscal year 2001.
[4] In order to comply with accelerated financial reporting deadlines, Rural Development revised its approach to performing the reestimates earlier using data prior to fiscal yearend. This is referred to as the approximated reestimates.
[5] This issue will be addressed from an overall departmental standpoint by the Consolidated Financial Statement Audit (Audit Report No. 50401-53-FM).

direct programs were not applied to all programs and were not applied consistently to all affected areas of the model used for those programs. The credit reform footnote errors occurred because the quality control review process did not identify the discrepancies in the footnote disclosure and the support documentation. Had the "approximated" errors not been identified by OIG and corrected by agency officials, Rural Development's "approximated" reestimates and ultimately its financial statements would have been misstated by approximately $140 million. An additional correction was made to the credit reform footnote for approximately $20 million to address a disclosure error.

Although Rural Development followed written procedures for making cash flow model changes, agency officials did not adequately review the changes made for non-housing direct programs. The model used for these programs was modified for only two programs during fiscal year 2004 for the fiscal year 2003 reestimates; however, other material programs had disbursements that were impacted by the model change.

In fiscal year 2003, Rural Development implemented additional procedures and checklists to improve its quality control process. While we acknowledge improvements have been made, we believe further improvements are needed as evidenced by the fact that Rural Development did not detect the errors within a timely period by employees in the normal course of performing their assigned functions. Working with Rural Development, OIG was able to obtain the information necessary to ensure the credit reform footnote was adequately and accurately supported.

Recommendation No. 1

Expand the credit reform "approximated" checklist to ensure all appropriate steps are performed. This should include procedures to verify that discount rates agree with the weighted average interest rate or single effective rates.

Recommendation No. 2

Ensure model changes are thoroughly evaluated to ensure enhancements are addressed properly and all programs impacted are considered.

Recommendation No. 3

Implement a tracking mechanism to maintain control over the final version of Rural Development's financial statement package including the credit reform footnote.

Agency Response. Rural Development management disagrees that Finding No. 2 represents a material weakness. The finding represents one time clerical errors detected during OIG's review of the credit reform process. These errors are not likely to be repeated and do not represent a material internal control structure weakness. Additionally, the potential $140 million misstatement is an estimate of the credit reform subsidy true-up and does not represent a material percentage of the Rural Development allowance accounts totaling over $12 billion.

OIG Position. We disagree with Rural Development's assessment that this represents a one time "clerical" error. Downloading the correct credit subsidy calculator and running the "approximated" reestimates is a key element of the credit reform process. Rural Development's "Instructions for Updating the OMB Reestimate Calculator" on page 3 states "Validate that the weighted average interest rate and single effective interest rate agree with the rates produced by the credit subsidy calculator." Had Rural Development compared the rates found in the OMB Federal Credit Support Page to the rates provided by the credit subsidy calculator the error could have been identified.

Errors were also made in the tables and multi-family housing program used to support the credit reform reestimates unrelated to the "approximated" process. These errors in multiple areas of the credit reform process totaled in excess of $250 million and are not clerical in nature.

Reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation that, in our judgment, could adversely affect the agency's ability to record, process, summarize, and report financial data consistent with the assertions by management in the consolidated financial statements.

Finding 3 Insufficient Review and Certification of Rural Electric and Telephone Unliquidated Obligations

Although Rural Development made progress in the certification process, they did not effectively review and certify that all rural electric and telephone unliquidated obligations were valid for fiscal year 2004. Additionally, Rural Development electric and telephone program personnel did not properly identify and deobligate unused loan funds from inactive accounts. These conditions occurred because Rural Development financial personnel did not provide rural electric and telephone program personnel with certification reports to review and certify $0.4 billion of fiscal year 2003 financing, $0.2 billion of liquidating, and $1.7 billion of Federal Financing Bank[6] unliquidated obligation balances as of March 31, 2004. Additionally, rural electric and telephone program personnel did not identify and deobligate unused loan funds from inactive accounts because telephone personnel believed legislation restricted them from rescinding funds from borrowers and files were not properly maintained and reviewed. As a result, Rural Development did not certify $2.3 billion (26 percent) of $8.9 billion of rural electric and telephone unliquidated obligations at March 31, 2004.[7] Additionally, 3 of the 53 sampled loans lacked adequate documentation to support retention of about $39 million in unliquidated obligations.

The Department of Treasury's fiscal yearend 2004 closing procedures require agencies that have not reviewed their unliquidated obligations during the year, to do so prior to yearend closing and to retain records on verifications to facilitate audits. In addition, Departmental Regulation 2230-001 requires the Chief Financial Officer, or equivalent, of each agency to (1) coordinate semiannual reviews of unliquidated obligations between program, contracting, and financial personnel for the

[6] Fiscal year 1992 - 2002 financing unliquidated obligations. Federal Financing Bank unliquidated obligation balances of $0.2 billion for fiscal year 2003 were included in the financing balance and $0.1 billion were included in the liquidating balance.

[7] Rural Development used the March 31, 2004 certification reports for rural electric and telephone to meet the semiannual review and the yearend certification requirements set forth in U.S. Department of Agriculture Departmental Regulation 2230-001.

periods ending March 31 and September 30; and (2) provide annual certification that semiannual reviews were performed and unliquidated obligations existing at fiscal yearend, and inactive for at least 12 months, are valid based on the reviews. Further, it states that all inactive unliquidated obligations over 2 years old must be selected for review and that a dollar majority of inactive unliquidated obligations less than 2 years old must be selected for review based on a sample. Finally, Section 206 of the Rural Electrification Act[8] states that insured telephone loans shall not be rescinded without the consent of the borrower unless all purposes of the loan have been accomplished.

Our review of a statistical sample of 53 rural electric and telephone unliquidated obligations in the amount of $2.2 billion revealed that Rural Development electric and telephone program personnel did not properly identify and deobligate unused loan funds from inactive accounts. Three of the 53 sampled loans lacked adequate documentation to support retention of about $39 million in unliquidated obligations. Specifically, we identified a liquidating telephone loan with an unliquidated obligation balance of about $32 million that was inactive for over 7 years and another telephone loan, obligated in 1995, with an unliquidated obligation balance over $6 million that was inactive for over 5 years. Rural Development program personnel did not deobligate the two telephone unliquidated obligations because Section 206 of the Rural Electrification Act prohibits them from rescinding an insured telephone loan without the consent of the borrower. However, Section 206 states that loans may be rescinded when all purposes of the loan have been accomplished. Program personnel did not determine if all purposes of the loan were accomplished and did not contact the borrowers to see if funds could be rescinded.

Recommendation No. 4

The Office of the Deputy Chief Financial Officer (DCFO) should obtain certification of all rural electric and telephone unliquidated obligations in accordance with Treasury and departmental guidance.

Agency Response. DCFO response. To comply with Treasury and departmental guidance, beginning in fiscal year 2005, the DCFO's staff will prepare reports of all unliquidated rural electric and telephone loan obligations as of March 31 and September 30 of each year. The reports of unliquidated obligations will be sent to the Rural Utilities Service electric and telephone program staffs for their review by June 30 and December 31, respectively. The reports will include instructions asking that the program staffs document whether obligations should be retained or rescinded.

[8] Rural Electrification Act of 1936, Title 7 USC 927(b)(1).

Additionally, the annual certification to the DCFO by the program staffs will be accomplished with the March 31 report of unliquidated obligations.

OIG Position. We concur with the management decision.

Recommendation No. 5

Rural electric and telephone program personnel should implement procedures to identify inactive telephone loans in which all purposes of the loan have been accomplished and deobligate all funds that are no longer needed.

Agency Response. Electric program response. Although the electric program loans have an automatic termination date, the obligation is not automatically terminated in the Federal Government's records until a certain amount of paperwork is completed. The Power Supply Division is working on completing the required paperwork so that this item can be closed out.

Telecommunications program response. The telecommunications program is, as noted correctly by OIG, prohibited from unilaterally rescinding loan funds from borrowers without their consent. Even though a particular loan's "purposes" may have been completed, prior loan funds may be used for other Rural Electrification Act purposes with Rural Utilities Service (RUS) approval. Nonetheless, the program has begun the process of contacting borrowers to deobligate funds that may no longer be needed. Specifically, as of August 2004, $110 million in rescissions requests have been secured and approximately $70 million processed. The program will continue this process to ensure that any unadvanced, unobligated funds that are not needed are rescinded. In addition, the agency put forth a legislative proposal to amend Section 206 of the Rural Electrification Act to allow for greater flexibility in rescinding aging unadvanced loan obligations. That legislative proposal is currently under departmental and legal review.

OIG Position. We concur with the management decision.

Under FFMIA, we are required to report whether Rural Development's financial management systems substantially comply with Federal Financial Management Systems Requirements (FFMSR), applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA, Section 803(a) requirements. The results of our tests disclosed instances where Rural Development's financial management systems did not substantially comply with these requirements.

Finding 4 Financial Management Systems Need Improvements

Rural Development reported in its most recent FFMIA Remediation Plan dated October 29, 2004, that its financial management systems are not in compliance with FFMSR. We concur with that conclusion. Rural Development reported the RUS legacy systems have not been certified and accredited in compliance with OMB Circular A-130, "Management of Federal Information Resources." As a result, there is no assurance that the RUS legacy systems have adequate security to prevent misuse or unauthorized access to or modification of information or to operate effectively and provide appropriate confidentiality, integrity, and availability.

Rural Development is in the process of incremental implementation of Rural Utilities Loan Servicing System (RULSS) to replace RUS legacy loan systems. Rural Development is also in the process of completing system certification and accreditation for the RUS legacy systems with a target date of June 2005. System certification and accreditation were completed on the remaining systems currently in place in July 2004.

The remediation plan also included corrective actions concerning the implementation of RULSS to address RUS legacy systems noncompliance with OMB Circular A-127, "Financial Management Systems." Rural Development has modified that plan and completed a Joint Financial Management Improvement Program (JFMIP) Direct Loan System Requirements review of the RUS legacy systems and determined the existing systems, procedures, and operations substantially comply with the JFMIP functionality. Additionally, Rural Development has determined that many of the problems and weaknesses that originally contributed to RUS legacy systems being substantially noncompliant have been largely resolved through compensating enhancements to operational procedures and controls.

Rural Development provided OIG a copy of this review on September 30, 2004, and the support for the review on October 6, 2004. However, due to the fact this review along with the support was provided on the last day of the fiscal year and subsequently, OIG has not had an opportunity to review this information and will defer comment until OIG has completed its review.

Based on current corrective action plans, we are making no further recommendations in this report.

Exhibit A – Consolidated Financial Statements

USDA
RURAL DEVELOPMENT

FISCAL YEARS 2004 and 2003

(PREPARED BY RURAL DEVELOPMENT)

USDA Rural Development

Committed to the future of rural communities.

Consolidated Financial Statements

Fiscal Year 2004 and 2003

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

Mission

This Management's Discussion and Analysis (MD & A), in conjunction with the accompanying consolidated financial statements, footnotes, and supplemental information, reflects the activities of the Rural Development mission area of the United States Department of Agriculture (USDA).

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

Rural Development programs are designed to meet the diverse needs of rural communities, to help them obtain the financial and technical assistance needed to improve the quality of life in rural America, and to help individuals and businesses compete in the global marketplace. These programs consist of a variety of loan, loan guarantee, and grant programs, plus technical assistance in the areas of business development; cooperative development; rural housing; community facilities; water and environment; electric power; and telecommunications, including distance learning and telemedicine.

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

Two key Rural Development goals are:

Goal 1. <u>Improve the Quality of Life in Rural America.</u> Rural Development will improve the quality of life in rural America by enhancing the ability of rural communities to develop, to grow, and to improve their quality of life by targeting financial and technical resources to areas of greatest need through activities of greatest efficacy.

Goal 2. Increase Economic Opportunity in Rural America. Rural Development will increase economic development in rural America by strengthening rural technology infrastructures, providing access to capital and credit for development, encouraging growth and establishment of rural businesses, and promoting energy independence.

Organizational Structure

Rural Development's mission area is comprised of Rural Housing, Rural Utilities, Rural Business-Cooperative, and the Office of Community Development program areas.

Loan Programs

Rural Development loan programs, with an outstanding portfolio of approximately $87.1 billion, are delivered through a National Office, 47 state offices, and a network of field offices. The mission area is supported by the Office of the Deputy Chief Financial Officer in St. Louis, Missouri, which provides accounting and service support for all mission area programs, and a Centralized Servicing Center, also in St. Louis, which services the Direct Single Family Housing (SFH) portfolio. The mission area serves 350,654 SFH borrowers; 15,479 multi-family housing (MFH) borrowers; 11,144 business and community borrowers; and 2,111 telecommunications, electric, cable TV, broadband and distance learning and telemedicine borrowers.

In addition, through a network of approximately 3,400 lenders, Rural Development guarantees loans for approximately 183,717 SFH; 62 MFH; 3,473 business & community service; and 22 electric & cable TV borrowers.

Rural Development loan programs generally require (1) providing loans to individuals and enterprises who are at a greater risk of default, since they lack the financial resources to obtain credit in the private sector, and (2) making loans bearing an interest rate at or less than the cost of funds. Rural Development has the responsibility to protect the interest of the Government by adequately securing the loans with real estate mortgages, assignments of income, personal and corporate guarantees, and liens on revenues.

The portfolio that follows reflects a total loan portfolio balance slightly higher in fiscal year (FY) 2004 than in FY 2003. The increase in the guaranteed portfolio from $18.4 billion to $19 billion offsets the decline in direct portfolio from $68.2 billion to $68.1 billion.

Total Loan Portfolio as of September 30, 2004
FY's 2002 Through 2004
(Dollars in Billions)

	FY 02	FY 03	FY 04
Direct Loans			
Single Family Housing	$15.1	$14.2	$13.6
Multi-Family Housing	11.9	11.8	11.8
Community Facilities/Other	1.1	1.3	1.4
Water & Environmental/Other	7.9	8.0	8.1
Electric	27.0	27.7	28.0
Telecommunications	3.6	3.6	3.6
Rural Telephone Bank	1.0	0.8	0.8
Business Programs	0.8	0.8	0.8
Total Direct	68.4	68.2	68.1
Guaranteed Loans			
Single/Multi-Family Housing	12.3	13.4	13.9
Community Facilities/Other	0.2	0.4	0.4
Water & Environmental/Other	0.1	0.1	0.1
Electric	0.5	0.5	0.5
Business Programs	2.9	4.0	4.1
Total Guaranteed	16.0	18.4	19.0
Total Loan Portfolio	$84.4	$86.6	$87.1

Rural Business-Cooperative Programs

The purpose of Rural Business-Cooperative Program is to enhance the quality of life for all rural Americans by providing leadership in building competitive businesses and sustainable cooperatives that can prosper in the global marketplace. Rural Development works in partnership with the private sector and community-based organizations to provide financial assistance and business planning. Rural Development helps fund projects that create or preserve quality jobs and/or promote a clean rural environment. The financial resources of RBS are often leveraged with those of other public and private credit source lenders to meet business and credit needs in under-served areas. Eligible recipients include individuals, Indian tribes, corporations, partnerships, cooperatives, and public bodies.

The National Office and nationwide Rural Development field staff, serving 50 States, the Virgin Islands, Puerto Rico, and Western Pacific Territories deliver all RBS programs.

The Business and Industry (B&I) Guaranteed Loan Program's primary purpose is to create and maintain employment and improve the economic climate in rural communities. This is achieved by expanding the lending capability of private lenders in rural areas, helping them make and service quality loans that provide lasting community benefits. The B&I program guarantees up to 80 percent of a loan made by a private lender that can be used to fund business and industrial acquisition, construction, conversion, enlargement, repair or modernization. The maximum aggregate amount to any one borrower is $25 million, with certain cooperative ventures able to receive loans up to $40 million.

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

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

The Rural Economic Development Loan (REDL) and Grant (REDG) programs provide grants and loans to Rural Development borrowers to promote sustainable rural economic development and job creation projects. Loans are used by electric or telephone utilities to relend, at zero percent interest, to eligible recipients.

The number of jobs to be created or saved is a critical element in determining the viability of a project for funding, and as such, is a key performance indicator.

The computed number of jobs created or saved is a 1 time count credited to each B&I loan when program funds are obligated. The number is based on credible information provided by the borrower and lender during the loan application process, based on a feasibility study or business plan, and is entered into the Agency's management database by Rural Development field staff. During the first year of the loan and subsequent compliance or servicing visits, Rural Development field staff update and verify the database. The number of jobs is only reported the year the loan is obligated.

Key Performance Indicator(s)

Rural Business- Cooperative Create or save jobs	FY 2004 Target	FY 2004 Actual
B&I Guaranteed Loans	18,826	24,743
IRP Loans	30,600	28,889
RBEG	17,206	18,542
REDL	2,449	2,513
REDG	844	1,734
Total	69,925	76,421

B&I exceeded the target for two reasons. First, carry-forward funds increased the B&I program level to $974,450,531. Second, the 47 state offices made substantial efforts to encourage loans from businesses with high employment possibilities.

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

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

Key Performance Indicator(s)

Business & Industry Loans Guaranteed	FY 2004 Target	FY 2004 Actual
Delinquency rate (excluding bankruptcy cases)	9.3%	7.7%

The delinquency goals for FY 2004 were met. The National Office and State staff have identified and begun intensive work with the highest risk loans.

In addition to training and oversight, borrowers and lenders are encouraged to work together to improve or maintain revenues and cut operating expenses so borrowers can continue to support both debt service and local employment.

Rural Housing Programs

Rural Housing programs improve the quality of life in rural America by building competitive, vibrant rural communities through its community facilities and housing programs.

Single Family Housing Programs

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

Rural Development also guarantees loans through partnerships with approximately 1,500 lenders. Loans may be guaranteed for an amount not to exceed 90 percent of the loan amount. Guaranteed loans are available for low and moderate-income families.

These loans are repaid over 30 years with the interest rates negotiated between the borrower and the lender. The guaranteed loan program reflects the commitment to achieve maximum leveraging of the federal loan funds.

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

Key Performance Indicator(s)

Single Family Housing	FY 2004 Target	FY 2004 Actual
Number of rural households receiving financial assistance to purchase a home of their own.	41,705	49,533

SFH programs exceeded the FY 2004 target by assisting over 7,800 additional households.

For direct SFH loans, delinquency rate provides a good indicator of how well the accounts are monitored and supervised.

Key Performance Indicator(s)

Single Family Housing	FY 2004 Target	FY 2004 Actual
Delinquency rate (Direct loans only)	Within 500 basis points of Federal Housing Administration rate	2Q-04 FHA rate = 12.52% RHS rate is 96 basis points better than the FHA rate

This indicator compares the Federal Housing Administration (FHA) quarterly delinquency rate, as reported by the Mortgage Banker's Association, to the USDA Direct SFH loan delinquency rate, net of foreclosures. The FHA rate includes all loans that are 30 days or greater delinquent; net of foreclosures that are more than 45 days old.

Housing and Urban Development's (HUD) raw delinquency number for June was 12.52% and USDA's was 14.47%, 195 basis points over HUD. When the USDA delinquency net of foreclosures (11.56%) is compared to HUD's net of foreclosures (12.52%), USDA is 96 basis points lower than HUD's results.

Multi-Family Housing Programs

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

Rural rental housing loans enable developers to provide housing for the elderly, disabled individuals, and families who cannot afford the purchase price and maintenance costs of their own houses. In addition, grants are provided to public nonprofit organizations to assist rental property owners and co-ops to repair and rehabilitate their units.

Farm labor housing loans and grants enable farmers, public or private nonprofit organizations, and units of state and local governments to develop or rehabilitate farm labor housing for seasonal and year-round workers.

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

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

Key Performance Indicator(s)

Multi-Family Housing	FY 2004 Target	FY 2004 Actual
Number of projects with accounts more than 180 days past due (Direct loans only)	140	137

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

Key Performance Indicator(s)

Multi-Family Housing	FY 2004 Target	FY 2004 Actual
Total number of units selected for funding for new construction	2,820	4,040
Total number of units selected for funding for rehabilitation	13,200	8,772
Decrease in number of families in substandard housing in the multi-family portfolio	3,428	2,105
Decrease in number of families in the multi-family properties paying more than 30 percent of income in rent	86,000	83,851
Increase the amount of leveraged funds in Rural Rental Housing for both new construction and rehabilitation	$65,000,000	$65,100,351

Due to a decrease in rental assistance/subsidy, fewer rehabilitation properties could be funded.

Community Facilities Programs

Community Facility programs offer both direct and guaranteed loans to public entities such as municipalities, counties, and special purpose districts as well as nonprofit corporations and tribal governments. These loans improve the quality of life of rural residents by providing access to modern, essential community facilities such as fire stations, health care clinics, and childcare facilities. Recipients must demonstrate that they are unable to obtain capital from commercial sources. The loans must be repaid within 40 years.

Low delinquency rates are a key indicator of the effectiveness of the program delivery. If the projects are beneficial to the community and well managed, the delinquency rates will be low, and the rural residents will continue to receive essential services.

Key Performance Indicator(s)

Community Facilities	FY 2004 Target	FY 2004 Actual
Delinquency rate for Community Facility customers	2%	2%

For the last 5 years**,** Community Facilities has accomplished this goal.

Rural Utilities Programs

Rural Utilities programs improve the quality of life in rural America by providing capital for its electric, telecommunications (including distance learning and telemedicine), and water and environmental projects in a service-oriented, forward-looking and financially responsible manner. The Rural Utilities programs leverage scarce federal funds with private capital for investing in rural infrastructure, technology, and the development of human resources. Financial assistance is provided to rural utilities; municipalities; commercial corporations; public utility districts; Indian tribes; and cooperative, nonprofit, limited-dividend, or mutual associations. These entities are obligated to serve the public welfare and, in many instances, are subject to state regulatory oversight.

Electric Program

The electric program makes loans and loan guarantees to finance the construction of electric distribution, transmission and generation facilities, including system improvements and replacement required to furnish and improve electric service in rural areas. Rural Development makes loans to corporations, states, territories, subdivisions, and agencies such as municipalities, utility districts, and cooperative, nonprofit, limited-dividend, or mutual associations that provide retail electric service needs to rural areas or power supply needs of distribution borrowers in rural areas. The program staff services approximately 683 active electric borrowers in 46 states, plus active territories of Marshall Islands, Puerto Rico, and American Samoa.

As restructuring of the electric industry advances toward a more competitive environment, Rural Development is ensuring the continued availability of reliable, high-quality electric service at a reasonable cost to rural consumers. The electric program provides financing and technical assistance to upgrade, expand, and maintain the vast rural American electric utility infrastructure.

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

Key Performance Indicator(s)

Rural Utilities - Electric Loans – Direct Loans	FY 2004 Target	FY 2004 Actual
Number of subscribers receiving new and/or improved service	233,966	327,504
Dollar amount for number of subscribers receiving new and/or improved service (millions)	240	240

The Electric Program met the FY 2004 target.

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

Guaranteed loans are provided by Rural Development primarily through the Federal Financing Bank (FFB), National Rural Utilities Cooperative Finance Corporation, and the National Bank for Cooperatives. The FFB is an agency within the Treasury

Department providing funding in the form of loans for various government lending programs, including the Rural Utility Guaranteed Loan Program. FFB loans are guaranteed by Rural Development and are available to all electric borrowers.

Telecommunications Program

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

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

Over the past 3 years, nearly $2.0 billion in loans have been provided to 141 entities for the deployment of advanced, state-of-the-art telecommunications networks serving rural areas. The facilities financed with these loans must be capable of offering high-speed service to all subscribers that request it. The primary technologies used to deliver this service are "digital subscriber line" - or DSL - service and "fiber-to-the-home" - or FTTH - systems.

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

Key Performance Indicator(s)

Rural Utilities - Telecommunication	FY 2004 Target	FY 2004 Actual
Number of subscribers receiving new and/or improved service	401,162	164,563
Leveraging of telecommunications financial assistance (private investment to Rural Development and Rural Telephone Bank funding)	$5:1	$3.74:1

The target for new and/or improved subscribers was not met. One reason for this was a change in authorization for utilization of funds. The 2002 Farm Bill allowed for the use of loan funds to refinance existing debt. The FY 2004 target had been based on prior experience whereby loan funds were used for new subscribers only. The target did not factor in the use of funds to refinance existing loans.

The leveraging performance indicator was not met. This indicator measures the extent to which borrowers are investing in plant with funds other than Rural Development funds. During the past year, a higher portion of funding was invested in plant from Rural Development and other government funds than other sources. Several factors contributed to this, including favorable terms associated with government loans (i.e., lower interest rates, and longer maturities) and a desire to increase cash reserves through a conservative cash management approach (resulting in fewer dollars invested from general funds).

The Distance Learning and Telemedicine Program

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

Key Performance Indictor(s)

Rural Utilities - Distance Learning and Telemedicine	FY 2004 Target	FY 2004 Actual
Number of schools receiving distance learning facilities	800	629
Number of healthcare providers receiving telemedicine facilities	425	183
Leveraging of telemedicine and distant learning financial assistance (private investment to Rural Development funding)	\$1:\$1	\$1:1

Neither target was met. The primary reason was the utilization of loan funds was very low, leaving approximately \$269 million in unused lending authority.

Broadband Program

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

The building and delivery of advanced telecommunications networks are having a profound effect on our Nation's economy, its strength, and its growth. Broadband networks in small rural towns will facilitate economic growth and provide the backbone for the delivery of increased educational opportunities over state-of-the-art telecommunications networks. While rural America can be defined by various statistics – number of counties: 2,300; or percentage of landmass 80 percent -- the most important statistic is that rural America is home to 55 million people. Just as our citizens in our cities and suburbs benefit from access to broadband services, so should our rural residents. In rural America, access to broadband plays a vital role in solving the problems created by time, distance, location, and lack of resources. The promise of broadband is not just "faster access," it means:

- New educational opportunities through distance learning – enabling rural students to take virtual field trips to places all over the world, from historic Williamsburg to the Louvre;

- Life saving medical treatment over telemedicine networks – allowing for specialists to guide surgeries hundreds of miles away; and

- Economic growth and new markets - where businesses prosper and grow locally, while competing nationally and globally over high-speed networks and inter-connecting with suppliers, manufacturers, and consumers to optimize business strategies.

Key Performance Indicator(s)

Rural Utilities - Broadband	FY 2004 Target	FY 2004 Target
Number of new or improved subscribers receiving service	349,850	221,426

The target was not met. Since the program is new, the target was based on the telecommunications dollars per subscriber factor and the utilization of $600 million in lending authority. Several large loans were made that consisted of a very high amount of investment per subscriber, which contributed to the lower actual subscriber figure. As the program gains its own history, targets should become more accurate.

Today’s advanced telecommunications networks will allow rural communities to become platforms of opportunity for new businesses to compete locally, nationally, and globally and ensure that no rural resident – from students to parents and teachers, from patients to doctors, or from consumers to entrepreneurs – will be left behind in this new century.

Water and Environmental Program

Water and Waste Disposal loans and grants are provided to rural communities for the development, replacement, or upgrading of water and environmental facilities. Direct loans are repayable up to 40 years. The Water and Environmental Program anticipates serving 162,500 subscribers quarterly and 650,000 on an annual basis. Targets are based on historical activity and are adjusted according to the program level received each fiscal year.

One of the objectives of the Water and Environmental Program is to provide rural residents with modern and affordable water and waste disposal services. Another objective is to direct program resources to those rural communities with the greatest need. This includes rural communities that are poverty-stricken as a result of out-migration, natural disasters or economic stress due to Federal actions.

Key Performance Indicator(s)

Rural Utilities – Water and Environmental	FY 2004 Target	FY 2004 Actual
Customers served by new or improved water & waste disposal facilities	650,000	965,780

Office of Community Development

Rural Development is dependent on the ability and skills of its staff for the effective delivery of the Community Development technical assistance programs. Recent internal organizational changes have established that Community Development technical assistance is the responsibility of every field office professional. This staff must be adequately trained and have the resources needed if it is to accomplish its job. To assist in the creation of jobs, Rural Development will make community development training a priority in order to maximize staff ability to work with our rural clients in a comprehensive and holistic manner. Rural Development will encourage a workplace environment that ensures all customers and employees are treated fairly, equitably, and with dignity and respect. Improved training will enhance the potential for delivering financial aid to those areas in greatest need of assistance. Improved training will improve the ability to ensure that funds are leveraged to the maximum extent with other funding sources and targeted to those communities where the creation of jobs is essential.

Key Performance Indicator(s)

Office of Community Development	FY 2004 Target	FY 2004 Actual
Number of jobs created in EZ/EC & REAP communities	7,000	2,516
Round II & III Communities' leveraged dollars	$ 81,116,000	$93,334,089

Rural Empowerment Zones and Enterprise Communities (EZ/EC) exceeded expectations for leveraging Federal funds. Actual jobs established in the USDA supported communities fell short of expectations in part because of staffing changes in the field that resulted in reduced support of designated communities and subsequent activity in our benchmark management system, where job information is collected. As the program ages and communities rely on Federal program funding, reporting has suffered without this Rural Development staff oversight. In addition, 28 communities will be graduating from the program this December. Some decline in reporting activity has also been observed with these communities.

Future Opportunities and Challenges

Rural Development is subject to many of the changes occurring in society as a whole and was impacted by the events of September 11, 2001. With security issues today, every Water and Environmental project receiving Rural Development assistance must be safe from terrorist attacks. Rural Development must periodically evaluate its business practices to determine how to continue operations in a time of national emergency. Other societal changes will potentially impact Rural Development programs and its operations in the future. Some opportunities and challenges resulting from these changes are summarized in the following areas:

Technology

Rural Development is responding to the increasing demand for eGovernment services and capabilities by supporting the USDA eGrants and eDeployment initiatives. Rural Development has recently developed a USDA-wide interface solution that allows USDA to receive grant applications from the GRANTS.GOV site in a fully automated seamless manner. As part of the eDeployment initiative Rural Development is currently developing the first USDA enterprise-wide document management application. Rural Development also currently offers via the Internet 139 forms to the public. These forms can be completed online and electronically submitted to field service centers for processing. Rural Development is promoting web-based business applications such as the capability to advertise and sell SFH properties via the Internet. This capability has been extended to the Farm Service Agency (FSA) in the advertisement and sale of farm properties. Rural Development is taking the lead in developing a “Homes for Sale” portal with HUD and the Department of Veterans Affairs.

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

Under development, is an initiative to provide a web-based, automated underwriting system to guaranteed loan lenders to allow them to more efficiently review and approve loan applications for Rural Development SFH guaranteed loans. In the near future, lenders participating in Rural Development's guaranteed loan programs will be able to submit loan loss claims via the Internet.

Within Rural Development, initiatives such as the Data Warehouse provide employees with faster and easier access to data that crosses all business lines. The demand to geo-code tabular loan data is growing significantly.

Rural Development is currently updating tactical business plans for all major loan programs that will outline how current business processes will be transformed in order to electronically deliver programs directly to the public.

USDA eAuthentication is a system utilized by USDA agencies to enable customers to obtain accounts that allow them to access USDA Web applications and services via the Internet. This includes submitting forms electronically, completing surveys online, and checking the status of USDA accounts. Rural Development is working with USDA, FSA, and the National Resource Conservation Service to deploy the secure technical infrastructure necessary to support the delivery of programs to the public and is collaborating closely with the USDA eAuthentication team to ensure customers have proper security for access to Rural Development automated systems.

Budget and Performance Integration

Budget and Performance Integration is the fifth government-wide initiative in the PMA. The initiative intends to provide a greater focus on performance, and to formally integrate the review of performance with budget decisions. This will require identifying high quality outcome measures, accurately monitoring the performance of programs, and measuring the total cost of programs.

Market Globalization

The advent of electronic commerce offers a great opportunity to rural businesses to participate in the global market, especially for the small entrepreneur or cooperative whose business is operating in a niche market. Electronic commerce eliminates factors such as geographical distance and small customer base which have historically limited the growth potential of rural businesses and communities.

Farm Bill

Passage of the Farm Security and Rural Development Act of 2002 had a broad impact on Rural Development programs and policies. The bill created a variety of new energy related and telecommunication programs and changed existing programs. This provides both an opportunity and a challenge to implement the provisions in a timely fashion to benefit the residents of rural America.

Diversity

The racial and ethnic backgrounds of our rural customers and our employees will continue to become more diverse. Rural Development gives priority to ensuring all customers, including employees, are treated with dignity and respect. This priority must continue if Rural Development is to ensure its programs are delivered equitably and its workforce recognizes the value of a diverse staff.

Highlights of Rural Development's Financial Position

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

Limitations on Financial Statements

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

Entity's Systems, Controls And Legal Compliance

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

Section 2

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

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

For FY 2004, Rural Development is reporting that our internal controls are substantially compliant with Section 2 of the FMFIA Report.

Section 4

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

For FY 2004, Rural Development certifies that our financial management systems are not compliant with Section 4 of the FMFIA Report.

Rural Development has exhibited a new commitment to addressing flaws in its Information Systems Security Program. Certification and accreditation has been completed for major applications and general support systems, except for the RUS Legacy Systems; audit findings and required corrective actions have been discussed with audit agencies; and a master plan was developed to identify tasks, timeframes, resources, interdependencies, and responsibilities.

Rural Development has initiated corrective actions to enhance network security and to strengthen logical access controls. Key actions include summarizing the corrected vulnerabilities and rescanning to verify the network security corrections by 2nd quarter FY 2005; developing a strategy regarding Rural Development's and the CIO's responsibilities by 2nd quarter FY 2005, developing a project plan outlining Rural Development's responsibilities by 3rd quarter FY 2005, and certification and accreditation of the RUS Legacy Systems by 3rd quarter FY 2005.

DEPARTMENT OF AGRICULTURE
RURAL DEVELOPMENT
CONSOLIDATED BALANCE SHEET
AS OF SEPTEMBER 30, 2004 AND 2003
(In Millions)

Assets (Note 2):	**2004**	**2003**
Intragovernmental:		
Fund Balance with Treasury (Note 3)	$ 11,211	$ 9,593
Accounts Receivable, Net (Note 5)	9	62
Total Intragovernmental	11,220	9,655
Cash and Other Monetary Assets (Note 4)	82	76
Accounts Receivable, Net (Note 5)	0	1
Loans Receivable and Related Foreclosed Property, Net (Note 6)	56,820	56,306
General Property, Plant and Equipment, Net (Note 7)	62	47
Other (Note 8)	37	37
Total Assets	68,221	66,122
Liabilities (Note 9):		
Intragovernmental:		
Accounts Payable	1	0
Debt (Note 10)	51,131	49,869
Resources Payable to Treasury (Note 1N)	8,350	7,704
Other (Note 12)	369	480
Total Intragovernmental	59,851	58,053
Accounts Payable	92	79
Loan Guarantee Liability (Note 6)	784	727
Debt Held by the Public (Note 10)	2	80
Stock Payable to RTB Borrowers (Note 11)	1,343	1,309
Federal Employee and Veterans Benefits (Note 9)	32	34
Other (Note 12)	192	161
Total Liabilities	62,296	60,443
Commitments and Contingencies (Note 13)		
Net Position:		
Unexpended Appropriations	5,506	5,700
Cumulative Results of Operations	419	(21)
Total Net Position	5,925	5,679
Total Liabilities and Net Position	$ 68,221	$ 66,122

The accompanying notes are an integral part of these statements.

DEPARTMENT OF AGRICULTURE
RURAL DEVELOPMENT
CONSOLIDATED STATEMENT OF NET COST
FOR THE YEARS ENDED SEPTEMBER 30, 2004 AND 2003
(In Millions)

Program Costs (Note 14):	**2004**	**2003**
Intragovernmental Gross Costs	$	$
Benefit Program Costs	68	64
Imputed Costs	98	95
Reimbursable Costs	69	64
Borrowing Interest Expense	3,104	3,186
Total Intragovernmental Gross Costs	3,339	3,409
Less: Intragovernmental Earned Revenue (Note 15)	349	322
Intragovernmental Net Costs	2,990	3,087
Gross Costs with the Public:		
Grants	1,692	1,530
Loan Cost Subsidies	300	855
Indemnities	(8)	8
Other	423	2,257
Total Gross Costs with the Public	2,407	4,650
Less: Earned Revenues from the Public (Note 15)	3,620	3,998
Net Costs with the Public	(1,213)	652
Net Cost Of Operations	$ 1,777	$ 3,739

The accompanying notes are an integral part of these statements.

DEPARTMENT OF AGRICULTURE
RURAL DEVELOPMENT
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
FOR THE YEARS ENDED SEPTEMBER 30, 2004 AND 2003
(In Millions)

	2004 Cumulative Results of Operations	2004 Unexpended Appropriations	2003 Cumulative Results of Operations	2003 Unexpended Appropriations
Beginning Balances	$ (21)	$ 5,700	$ 367	$ 5,362
Prior Period Adjustments	0	0	0	0
Beginning Balances, as Adjusted	(21)	5,700	367	5,362
Budgetary Financing Sources:				
Appropriations Received	0	3,154	0	3,211
Appropriations Transferred-in/out	0	19	0	18
Other Adjustments (rescissions, etc.)	0	(47)	(15)	(66)
Appropriations Used	3,320	(3,320)	2,825	(2,825)
Transfers-in/out Without Reimbursement	(1,201)	0	446	0
Other Financing Sources:				
Imputed Financing from Costs Absorbed by Others	98	0	95	0
Total Financing Sources	2,217	(194)	3,351	338
Net Cost of Operations	1,777	0	3,739	0
Ending Balances	$ 419	$ 5,506	$ (21)	$ 5,700

The accompanying notes are an integral part of these statements.

DEPARTMENT OF AGRICULTURE
RURAL DEVELOPMENT
COMBINED STATEMENT OF BUDGETARY RESOURCES
FOR THE YEARS ENDED SEPTEMBER 30, 2004 AND 2003

(In Millions)

	2004 Budgetary	2004 Non-Budgetary Credit Program Financing Accounts	2003 Budgetary	2003 Non-Budgetary Credit Program Financing Accounts
Budgetary Resources:				
Budget Authority:				
Appropriations Received	$ 3,457	$ 0	$ 3,545	$ 0
Borrowing Authority (Notes 17 & 18)	2	8,480	0	7,376
Net Transfers	3	0	82	0
Unobligated Balance:				
Beginning of Period	2,298	1,391	1,487	1,076
Spending Authority from Offsetting Collections:				
Earned				
Collected	5,852	4,943	6,382	4,471
Receivable from Federal Sources	(15)	(4)	69	4
Change in Unfilled Customer Orders				
Without Advance from Federal Sources	0	(96)	0	48
Subtotal	5,837	4,843	6,451	4,523
Recoveries of Prior Year Obligations	309	543	193	346
Permanently Not Available	(2,981)	(2,346)	(4,101)	(1,866)
Total Budgetary Resources	$ 8,925	$ 12,911	$ 7,657	$ 11,455

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

The accompanying notes are an integral part of these statements.

U.S. DEPARTMENT OF AGRICULTURE
RURAL DEVELOPMENT
COMBINED STATEMENT OF BUDGETARY RESOURCES
FOR THE YEAR ENDED SEPTEMBER 30, 2004 AND 2003
(In Millions)

	2004 Budgetary	2004 Non-Budgetary Credit Program Financing Accounts	2003 Budgetary	2003 Non-Budgetary Credit Program Financing Accounts
Status of Budgetary Resources:				
Obligations Incurred: (Note 16)				
Direct	$ 4,665	$ 11,096	$ 4,872	$ 10,064
Reimbursable	509	0	487	0
Subtotal	5,174	11,096	5,359	10,064
Unobligated Balance:				
Apportioned	396	1,434	317	1,043
Unobligated Balance Not Available	3,355	381	1,981	348
Total Status of Budgetary Resources	$ 8,925	$ 12,911	$ 7,657	$ 11,455
Relationship of Obligations to Outlays:				
Obligated Balance, Net, Beginning of Period	6,916	14,389	6,773	13,157
Obligated Balance, Net, End of Period:				
Accounts Receivable	(78)	0	(94)	(4)
Unfilled Customer Orders from Federal Resources	0	(618)	0	(714)
Undelivered Orders	6,319	17,547	6,599	15,105
Accounts Payable	285	0	411	2
Outlays:				
Disbursements	5,270	8,113	4,954	8,434
Collections	(5,852)	(4,943)	(6,382)	(4,471)
Subtotal	(582)	3,170	(1,428)	3,963
Less: Offsetting Receipts	387	0	790	0
Net Outlays	$ (969)	$ 3,170	$ (2,218)	$ 3,963

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

The accompanying notes are an integral part of these statements.

DEPARTMENT OF AGRICULTURE
RURAL DEVELOPMENT
CONSOLIDATED STATEMENT OF FINANCING
FOR THE YEARS ENDED SEPTEMBER 30, 2004 AND 2003
(In Millions)

Resources Used to Finance Activities:	**2004**	**2003**
Budgetary Resources Obligated		
Obligations Incurred	$ 16,270	$ 15,423
Less: Spending Authority from Offsetting Collections and Recoveries	11,532	11,513
Obligations Net Offsetting Collections and Recoveries	4,738	3,910
Less: Offsetting Receipts	387	790
Net Obligations	4,351	3,120
Other Resources		
Imputed Financing from Costs Absorbed by Others	98	95
Net Other Resources Used to Finance Activities	98	95
Total Resources Used to Finance Activities	4,449	3,215
Resources Used to Finance Items Not Part of the Net Cost of Operations:		
Change in Budgetary Resources Obligated for Goods, Services and Benefits Ordered But Not Yet Provided	2,259	1,472
Resources That Fund Expenses Recognized in Prior Periods	604	344
Budgetary Offsetting Collections and Receipts That Do Not Affect Net Cost of Operations		
Credit Program Collections Which Increase Liabilities for Loan Guarantees or Allowances for Subsidy	(10,245)	(10,399)
Other	(387)	(790)
Resources That Finance the Acquisition of Assets	9,375	9,994
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	1,606	621
Total Resources Used to Finance the Net Cost of Operations	2,843	2,594
Components of the Net Cost of Operations That Will Not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Periods:		
Increase in Annual Leave Liability	3	0
Upward/Downward Reestimates of Credit Subsidy Expense	(124)	418
Other	(6)	0
Total Components of Net Cost of Operations That Will Require or Generate Resources in Future Periods	(127)	418
Components Not Requiring or Generating Resources:		
Depreciation and Amortization	4	4
Other	(943)	723
Total Components of Net Cost of Operations That Will Not Require or Generate Resources	(939)	727
Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period	(1,066)	1,145
Net Cost of Operations	$ 1,777	$ 3,739

The accompanying notes are an integral part of these statements.

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the United States Department of Agriculture (USDA) Rural Development mission area. The financial statements have been prepared from the books and records in accordance with the Office of Management and Budget (OMB) Bulletin 01-09, *Form and Content of Agency Financial Statements.*

B. Reporting Entity

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

C. Basis of Accounting

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

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

All significant interfund and intrafund balances and transactions have been eliminated in the consolidation except for those Credit Reform transactions impacting the Statements of Budgetary Resources and Financing.

D. Estimates

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

E. Revenue and Other Financing Sources

<u>Revolving/Credit Funds:</u>
Beginning in fiscal year (FY) 1992, the Federal Credit Reform Act of 1990 contained in the Omnibus Budget Reconciliation Act of 1990, provided Credit Reform procedures which affected the financing of the revolving funds. Under Credit Reform, an appropriation is received in the year of loan making sufficient to cover the subsidy cost of providing the loan. The subsidy cost is defined as the net present value, at the time of disbursement, of the difference between the Government's estimated cash disbursements for that loan and the Government's estimated cash inflows resulting from that loan (e.g., repayments of principal and interest, and other payments adjusted for estimated defaults, prepayments, fees, penalties, and other recoveries). Consequently, the implementation of Credit Reform has resulted in authorized appropriations which provide for estimated future losses as opposed to reimbursement for losses appropriations which provided for past losses actually sustained prior to FY 1992. In addition to subsidy appropriations, the other sources of funding for the revolving funds include borrowings from Treasury and borrower loan repayments.

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

F. Fund Balance with Treasury

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

G. Escrow Disbursement Account

With the implementation of the Centralized Servicing Center on October 1, 1996, Rural Development began collecting escrow payments (i.e., insurance and taxes) from new Single Family Housing borrowers. Existing borrowers, which are delinquent and require servicing actions, must also submit escrow payments. The escrow payments are deposited with the

Trustee, U.S. Bank. As Trustee, they are required to invest these funds and disburse them as stipulated in the Trust Agreement. As of September 30, 2004 and 2003, the balance in this account was $82 million and $76 million, respectively. This amount has been included in the Consolidated Balance Sheet on the Cash and Other Monetary Assets **(Note 2)** and Other Liabilities **(Note 12)** lines. It has also been included on the Cash and Total Cash and Other Monetary Assets lines **(Note 4).**

H. Lending Activities

Appropriated authority is received to make direct loans. These loans represent actual cash disbursements to borrowers which require repayment.

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

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

I. Loans Receivable and Related Foreclosed Property, Net

Loans are accounted for as receivables after funds have been disbursed. They are carried at their principal amount outstanding **(Note 6**), and accrue interest based on the contractual interest rate. When a loan becomes nonperforming (in excess of 90 days delinquent or when borrowers enter into troubled debt restructuring arrangements), all interest previously accrued on the loan is reversed for financial reporting purposes, and interest income on the nonperforming loan is then recognized only to the extent of the collections received. Nonperforming loans are reclassified as performing and accrue interest when they become current or less than 90 days delinquent. In addition, interest income recognition subsequent to troubled debt restructuring arrangements is generally limited to actual cash interest received from these borrowers.

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

J. Property, Plant and Equipment (PP&E)

The land, buildings, and equipment in the current operating environment are provided by the General Services Administration, who charges a Standard Level Users Charge that approximates the commercial rental rates for similar properties. Under Credit Reform, all equipment purchases are made through the Salaries and Expense fund. See **Note 7** for the capitalization thresholds of the various classes of PP&E.

Costs of Internal Use Software are accounted for in accordance with Statements of Federal Financial Accounting Standards (SFFAS) #10, Accounting for Internal Use Software. SFFAS #10 requires the capitalization of the cost of Internal Use Software whether it is commercial off-the-shelf, contractor-developed, or internally-developed which solely meets internal or operational needs.

Internal Use Software is classified as "general property, plant and equipment" as defined in the SFFAS, Accounting for Property, Plant and Equipment. See **Note 7** for further information.

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

K. Liabilities

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

L. Borrowings/Interest Payable to the Treasury

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

M. Pension and Other Employee Benefits

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

N. Resources Payable to Treasury

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

O. Contingencies

The Rural Development mission area is a party in various legal actions and claims through the normal course of its operations. In the opinion of management and the USDA Office of the General Counsel, the ultimate resolution of these legal actions and claims will not materially affect the financial position or results of operations **(Note 13)**.

P. Unexpended Appropriations

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

Q. Intragovernmental Financial Activities

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

The USDA has provided mission areas with an allocation of departmental nonreimbursed appropriated costs to include in their financial statements. These costs affect the Statement of Net Cost, Statement of Changes in Net Position, and the Statement of Financing.

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

The Rural Telephone Bank (RTB), which is an integral part of the Rural Development financial statements, has independent audited financial statements. The government's vested interest in the Rural Telephone Bank is commonly referred to as "Class A stock". Rural Development owns all Class A stock on behalf of the U.S. Government and any cash dividends are paid to the U. S. Treasury. On September 30, 2004, and September 30, 2003, in accordance with Bank Board resolutions 2004-1 and 2003-2, the ninth and eighth redemptions of Class A stock, in the amounts of $20.4 million and $21.5 million occurred, leaving balances of $388.3 million and $408.7 million outstanding, respectively, which has been eliminated in the consolidation. Additional information on stock owned by borrowers and third parties is reported in **Note 11**.

R. Accounting Presentation Changes

For FY 2004, the accounting presentation for RTB cumulative results has been changed from the FY 2003 statements. All statements, with the exception of the Statement of Budgetary Resources, were impacted; however, the changes were not material to the Rural Development statements and should not impact comparability. Below summarizes the impact on the FY 2004 financial statement line items created by the change in the accounting presentation. The $31.5 million was derived from the FY 2003 activity and is the amount that would have impacted cumulative results if the change was implemented during FY 2003.

- Balance Sheet was reclassified from Stock Payable to RTB borrowers to the Cumulative Results of Operations.

- Statement of Net Cost line item entitled "Gross Costs with the Public – Other" decreased which impacted the total amount of Net Costs of Operations.

- Statement of Changes in Net Position total amount of Net Costs of Operations shown on this statement was decreased.

- Statement of Financing included this amount in the line entitled "Other" which directly affects the total of Components of Net Costs of Operations that will not require or generate resources in future periods.

NOTE 2: NON-ENTITY ASSETS

Amounts are presented in millions.

	FY 2004	FY 2003
With the Public		
Cash and Other Monetary Assets	$ 82	$ 76
Total Non-Entity Assets	82	76
Total Entity Assets	68,139	66,046
Total Assets	$ 68,221	$ 66,122

See **Note 1G** for a description of Cash and Other Monetary Assets.

Non-Entity Assets represent assets that are **"not for use"** by Rural Development.

NOTE 3: FUND BALANCE WITH TREASURY

Amounts are presented in millions

	FY 2004	FY 2003
Fund Balances:		
Revolving Funds	$ 4,960	$ 3,153
Appropriated Funds	6,252	6,442
Other Fund Types	(1)	(2)
Total	$ 11,211	$ 9,593
Status of Fund Balance with Treasury:		
Unobligated Balance:		
Available	$ 1,078	$ 896
Unavailable	61	57
Unavailable – Restricted	3,204	1,747
Obligated Balance Not Yet Disbursed	6,866	6,892
Clearing Account Balances	2	1
Total	$ 11,211	$ 9,593

Represents the undisbursed account balances with the U.S. Treasury as reported in the mission area's records.

The amounts included on the Unavailable – Restricted line are limited in their future use and are not apportioned for current use. These amounts represent the expired authority in fixed year Grant and Program accounts (fixed years prior to FY 2004) and are only available for restoration of funds. After the fifth year of expiration, all funds are returned to Treasury as required except those entities having extended authority.

NOTE 4: CASH AND OTHER MONETARY ASSETS

Amounts are presented in millions.

	FY 2004	FY 2003
Cash	$ 82	$ 76
Total Cash and Other Monetary Assets	$ 82	$ 76

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

NOTE 5: ACCOUNTS RECEIVABLE, NET

Amounts are presented in millions.

	FY 2004		
	Accounts Receivable, Gross	**Allowance for Uncollectible Accounts**	**Accounts Receivable, Net**
Intragovernmental			
A/R Revenue, Refund, Reimbursements	$ 9	$ 0	$ 9
Total Intragovernmental Accounts Receivable	9	0	9
With the Public			
Audit Receivable	0	0	0
Total Accounts Receivable	$ 9	$ 0	$ 9

	FY 2003		
	Accounts Receivable, Gross	**Allowance for Uncollectible Accounts**	**Accounts Receivable, Net**
Intragovernmental			
A/R Revenue, Refund, Reimbursements	$ 62	$ 0	$ 62
Total Intragovernmental Accounts Receivable	62	0	62
With the Public			
A/R Revenue, Refund, Reimbursements	0	0	0
Audit Receivable	1	0	1
Total Accounts Receivable	$ 63	$ 0	$ 63

As of September 30, 2004 and 2003, the establishment of an allowance for uncollectible amounts was deemed unnecessary.

NOTE 6: LOANS RECEIVABLE AND RELATED FORECLOSED PROPERTY, NET

Balance Sheet Review

Direct loan obligations or loan guarantee commitments made post-1991, and the resulting direct loan or loan guarantees, are governed by the Federal Credit Reform Act of 1990 as amended. The Act requires agencies to estimate the cost of direct loans and loan guarantees at present value for the budget. Additionally, the present value of the subsidy costs (i.e. interest rate differentials, interest subsidies, delinquencies and defaults, fee offsets and other cash flows) associated with direct loans and loan guarantees are recognized as a cost in the year the loan or loan guarantee is disbursed. The net present value of loans or defaulted guaranteed loans receivable at any point in time is the amount of the gross loan or defaulted guaranteed loans receivable less the present value of the subsidy at that time.

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

Direct Loans

Loans receivable and related foreclosed property, net balances at the end of FY 2004 were $57 billion compared to $56 billion at the end of FY 2003. Defaulted guaranteed programs were $176 million and $187 million at the end of FY's 2004 and 2003, respectively. Table 1 below illustrates the overall composition of the Rural Development loan portfolio by mission area and loan program for FY 2004. Direct loan obligations or loan guarantee commitments made pre-1992 and the resulting direct loans or loan guarantees are reported at net present value. The provision calculation is based upon the weighted-averaged subsidy rate of the financing account cohorts which have been substantially disbursed. In the case of most loan programs, substantially disbursed is 90 percent.

During the fiscal year, the gross outstanding balance of the direct loans obligated post-1991 is adjusted by the value of the subsidy cost allowance held against those loans. Current year subsidy expense, modifications, and reestimates all contribute to the change of the subsidy cost allowance throughout the year. The subsidy cost allowance moved from $4.2 billion to $3.8 billion during FY 2004, a decrease of $400 million. During FY 2003, the allowance increased $400 million. Table 2 shows the reconciliation of subsidy cost allowance balances from FY 2003 to FY 2004.

Total direct loan subsidy expense for FY 2004 is a combination of subsidy expense for new direct loans disbursed in the current year, modifications to existing loans, and interest rate and technical reestimates to existing loans. Total direct loan subsidy expense in FY 2004 was $97 million compared to $629 million in FY 2003, a decrease of $532 million. This decrease is largely due to the electric loan programs. Table 3 illustrates the breakdown of total subsidy expense for FY's 2004 and 2003 by program.

Direct loan volume decreased from $5.5 billion in FY 2003 to $5.4 billion in FY 2004. Volume distribution between programs is shown in Table 4. The electric loan disbursements declined while the housing loans increased in FY 2004.

Table 1

Total Credit Program Receivables and Related Foreclosed Property (in millions)

FY 2004

Direct Loans	**Loans Receivable, Gross**	**Interest Receivable**	**Foreclosed Property**	**Present Value Allowance**	**Value of Assets**
Obligated Pre-1992					
Housing Loans	$ 12,949	$ 123	$ 17	$ (5,558)	$7,531
Electric Loans	13,283	27	0	(1,779)	11,531
Telecommunications Loans	1,665	9	0	(166)	1,508
Rural Telephone Bank	424	1	0	6	431
Rural Development *	2,120	21	0	(319)	1,822
Development Loan Funds	55	0	0	(27)	28
Other Programs	4	0	0	0	4
Pre-1992 Total	**30,500**	**181**	**17**	**(7,843)**	**22,855**
Obligated Post-1991					
Housing Loans	12,451	70	23	(1,980)	10,564
Community Facility Loans	1,424	17	2	(87)	1,356
Electric Loans	14,675	5	0	(749)	13,931
Telecommunications Loans	1,975	2	0	(8)	1,969
Rural Telephone Bank	364	0	0	4	368
Water and Environmental Loans	6,009	63	0	(760)	5,312
Development Loan Funds	359	2	0	(150)	211
Business & Industry Funds	89	0	0	(78)	11
Economic Development	75	0	0	(8)	67
Post-1991 Total	**37,421**	**159**	**25**	**(3,816)**	**33,789**
Total Direct Loan Receivables	**67,921**	**340**	**42**	**(11,659)**	**56,644**
Defaulted Guaranteed Loans					
Pre-1992					
Rural Development Insurance Fund	5	1	0	0	6
Post-1991					
Community Facilities	4	0	0	0	4
Business and Industry	176	0	0	(10)	166
Total Defaulted Guaranteed Loans	**$ 185**	**$ 1**	**$ 0**	**$ (10)**	**$ 176**
Total Loans Receivable and Related Foreclosed Property, Net					**$56,820**

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

Total Credit Program Receivables and Related Foreclosed Property (in millions)

FY 2003

Direct Loans	**Loans Receivable, Gross**	**Interest Receivable**	**Foreclosed Property**	**Present Value Allowance**	**Value of Assets**
Obligated Pre-1992					
Housing Loans	$13,885	$ 117	$ 30	$ (5,760)	$8,272
Electric Loans	15,262	6	0	(1,935)	13,333
Telecommunications Loans	1,843	1	0	(147)	1,697
Rural Telephone Bank	476	1	0	12	489
Rural Development *	2,463	25	0	(396)	2,092
Development Loan Funds	58	0	0	(29)	29
Other Programs	4	0	0	0	4
Pre-1992 Total	**33,991**	**150**	**30**	**(8,255)**	**25,916**
Obligated Post-1991					
Housing Loans	12,144	53	30	(1,872)	10,355
Community Facility Loans	1,290	15	1	(108)	1,198
Electric Loans	12,413	198	0	(1,113)	11,498
Telecommunications Loans	1,737	1	0	(46)	1,692
Rural Telephone Bank	328	0	0	(2)	326
Water and Environmental Loans	5,565	49	0	(809)	4,805
Development Loan Funds	347	2	0	(150)	199
Business & Industry Funds	105	0	0	(39)	66
Economic Development	74	0	0	(10)	64
Post-1991 Total	**34,003**	**318**	**31**	**(4,149)**	**30,203**
Total Direct Loan Receivables	**67,994**	**468**	**61**	**(12,404)**	**56,119**
Defaulted Guaranteed Loans					
Pre-1992					
Rural Development Insurance Fund	4	1	0	0	5
Post-1991					
Community Facilities	0	0	0	0	0
Business and Industry	189	3	0	(10)	182
Total Defaulted Guaranteed Loans	**$ 193**	**$ 4**	**$ 0**	**$ (10)**	**$ 187**
Total Loans Receivable and Related Foreclosed Property, Net					**$56,306**

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

Table 2

Schedule for Reconciling Subsidy Cost Allowance Balances (Post-1991 Direct Loans)
(in millions)

Beginning Balance, Changes, and Ending Balance	**FY 2004**	**FY 2003**
Beginning Balance of the subsidy cost allowance	**$ 4,159**	**$ 3,800**
Add: Subsidy expense for direct loans disbursed during the year by component		
Interest rate differential costs	(75)	113
Default costs (net of recoveries)	38	29
Fees and other collections	(12)	(32)
Other subsidy costs	345	225
Total of the above subsidy expense components	296	335
Adjustments		
Fees received	17	13
Loans written off	(92)	(81)
Subsidy allowance amortization	(340)	(87)
Other	(15)	(115)
Ending balance of the subsidy cost allowance before reestimates	4,025	3,865
Add or subtract subsidy reestimates by component		
Interest rate reestimates	287	135
Technical/default reestimate	(486)	159
Total of the above reestimate components	(199)	294
Ending balance of the subsidy cost allowance	**$ 3,826**	**$ 4,159**

Table 3

Direct Loan Subsidy by Program and Component
(in millions)

CURRENT REPORTING YEAR	Subsidy Expense for New Direct Loans Disbursed					Reestimates			
	Interest Differ-ential	Defaults	Fees and Other Colls	Other	Total	Interest Rate	Technical	Total	GRAND TOTAL
Direct Loan Programs									
Housing Loans	$ (161)	$ 32	$ (12)	$356	$ 215	$ 3	$ (23)	$ (20)	**$195**
Community Facility Loans	14	1	0	(1)	14	(13)	(1)	(14)	**0**
Electric Loans	(19)	3	0	(6)	(22)	352	(455)	(103)	**(125)**
Telecommunications Loans	0	1	0	(1)	0	12	(40)	(28)	**(28)**
Rural Telephone Bank	1	0	0	0	1	(3)	(5)	(8)	**(7)**
Water and Environmental Loans	73	1	0	(3)	71	(67)	4	(63)	**8**
Development Loan Funds	13	0	0	0	13	(1)	(2)	(3)	**10**
Business & Industry Funds	0	0	0	0	0	5	37	42	**42**
Economic Development	4	0	0	0	4	(1)	(1)	(2)	**2**
Total Subsidy Expense, Direct Loans	$ (75)	$ 38	$(12)	$345	$296	$ 287	$ (486)	$(199)	**$ 97**

PRIOR REPORTING YEAR	Subsidy Expense for New Direct Loans Disbursed					Reestimates			
	Interest Differ-ential	Defaults	Fees and Other Colls	Other	Total	Interest Rate	Technical	Total	GRAND TOTAL
Direct Loan Programs									
Housing Loans	$ 11	$ 23	$(32)	$231	$233	$ 4	$ (192)	$(188)	**$ 45**
Community Facility Loans	18	1	0	(1)	18	1	(8)	(7)	**11**
Electric Loans	(19)	4	0	(2)	(17)	94	359	453	**436**
Telecommunications Loans	2	0	0	0	2	6	30	36	**38**
Rural Telephone Bank	1	0	0	0	1	0	(6)	(6)	**(5)**
Water and Environmental Loans	85	1	0	(3)	83	39	(36)	3	**86**
Development Loan Funds	12	0	0	0	12	(6)	3	(3)	**9**
Business & Industry Funds	0	0	0	0	0	(3)	10	7	**7**
Economic Development	3	0	0	0	3	0	(1)	(1)	**2**
Total Subsidy Expense, Direct Loans	$ 113	$ 29	$(32)	$225	$335	$ 135	$ 159	$ 294	**$629**

Table 4

Total Amount of Direct Loans Disbursed (Post-1991)
(in millions)

Direct Loans	**Current Year**	**Prior Year**	**Current Year Over (Under) Prior Year**
Housing Loans	$ 1,395	$ 1,163	$ 232
Community Facility Loans	231	228	3
Electric Loans	2,600	3,007	(407)
Telecommunications Loans	378	300	78
Rural Telephone Bank	67	56	11
Water and Environmental Loans	700	754	(54)
Development Loan Funds	28	26	2
Business & Industry Loans	0	2	(2)
Economic Development	16	11	5
Total Direct Loans Disbursed	**$ 5,415**	**$ 5,547**	**$ (132)**

Guaranteed Loans

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

Guaranteed loans outstanding at the end of FY 2004 increased compared to the FY 2003 portfolio. At the end of FY 2004 and FY 2003, there were $18.7 and $18.4 billion in outstanding principal (face value) and $16.2 and $16 billion in outstanding principal (guaranteed), respectively. Table 5 shows the outstanding balances by loan program. The liability for loan guarantees and for guaranteed loans obligated prior to October 1, 1991, are reported at present value which is the same methodology used by the direct loan programs. The provision calculation is based upon future cash flows discounted at the average interest rate of the U.S. Treasury interest-bearing debt. The estimate is reported as an expense, and a corresponding accrual for estimated losses on loan guarantees is reported as a liability.

During the fiscal year, the value of the guaranteed loans is adjusted by the value of the loan guarantee liability held against those loans. For the post-1991 guarantees, current year subsidy expense and reestimates all contribute to the change of the loan guarantee liability through the year. The loan guarantee liability is a combination of the liability for losses on pre-1992 guarantees and post-1991 guarantees. The total liability moved from $727 million to

$784 million during FY 2004, an increase of $57 million. The post-1991 liability moved from $724 million to $781 million, an increase of $57 million. Table 6a shows the loan guarantee liability while table 6b shows the liability reconciliation for post-1991 guarantees.

Total guaranteed loan subsidy expense for FY 2004 is a combination of subsidy expense for new guaranteed loans disbursed in the current year and the interest rate and technical reestimates to existing loans. Total guaranteed loan subsidy expense in FY 2004 was $202 million compared to $226 million in FY 2003, a decrease of $24 million. This decrease was due to Housing and the Business and Industry guaranteed programs. Table 7 illustrates the breakdown of total subsidy expense for FY 2004 and FY 2003 by loan program.

Guaranteed loan volume (face value) increased from $3.8 billion in FY 2003 to $4.5 billion in FY 2004. The Housing loans and Business and Industry loans experienced the largest increases. Volume distribution between programs is shown in Table 8.

Table 5

Loan Guarantees Outstanding
(in millions)

	Pre-1992 Outstanding Principal, Face Value	Post-1991 Outstanding Principal, Face Value	Total Outstanding Principal, Face Value	Pre-1992 Outstanding Principal, Guaranteed	Post-1991 Outstanding Principal, Guaranteed	Total Outstanding Principal, Guaranteed
Guaranteed Loans (FY 2004)						
Housing Loans	$ 9	$13,549	$13,558	$8	$12,194	$12,202
Community Facility Loans	0	437	437	0	375	375
Electric Loans	255	221	476	255	221	476
Business and Industry Loans	41	4,194	4,235	31	3,105	3,136
Water and Environmental	0	33	33	0	27	27
Other Programs	4	0	4	3	0	3
Total Guarantees Disbursed	**309**	**18,434**	**18,743**	**297**	**15,922**	**16,219**
Guaranteed Loans (FY 2003)						
Housing Loans	11	13,420	13,431	10	12,078	12,088
Community Facility Loans	0	373	373	0	319	319
Electric Loans	293	224	517	293	224	517
Business and Industry Loans	51	4,031	4,082	39	2,975	3,014
Water and Environmental	0	29	29	0	23	23
Other Programs	4	0	4	3	0	3
Total Guarantees Disbursed	**$359**	**$18,077**	**$18,436**	**$345**	**$15,619**	**$15,964**

Table 6a

Liability for Loan Guarantees
(in millions)

	FY 2004			FY 2003		
	Liabilities for Losses on Pre-1992 Guarantees Present Value	**Liabilities for Loan Guarantees on Post-1991 Guarantees Present Value**	**Total Liabilities for Loan Guarantees**	**Liabilities for Losses on Pre-1992 Guarantees Present Value**	**Liabilities for Loan Guarantees on Post-1991 Guarantees Present Value**	**Total Liabilities for Loan Guarantees**
Liability for Loan Guarantees						
Housing Loans	$0	$441	$441	$0	$399	$399
Community Facility Loans	0	7	7	0	1	1
Electric Loans	0	0	0	0	0	0
Business and Industry Loans	3	333	336	3	324	327
Water and Environmental Loans	0	0	0	0	0	0
Other Programs	0	0	0	0	0	0
Total Liabilities for Loan Guarantees	$3	$781	$784	$3	$724	$727

Table 6b

Schedule for Reconciling Loan Guarantee Liability
(in millions)

Beginning Balance, Changes, and Ending Balance	**FY 2004**	**FY 2003**
Beginning Balance of the loan guarantee liability	**$ 724**	$ **477**
Add: Subsidy expense for guaranteed loans disbursed during the year by component		
Interest supplement costs	8	6
Default costs (net of recoveries)	145	172
Fees and other collections	(60)	(109)
Other subsidy costs	0	0
Total of the above subsidy expense components	93	69
Adjustments:		
Fees received	69	57
Interest supplements paid	0	0
Claim payments to lenders	(190)	(146)
Interest accumulation on the liability balance	13	31
Other	(37)	79
Ending balance of the loan guarantee liability before reestimates	672	567
Add or subtract subsidy reestimates by component:		
Interest rate reestimate	48	26
Technical/default reestimate	61	131
Total of the above reestimate components	109	157
Ending balance of the loan guarantee liability	**$ 781**	**$ 724**

Table 7

Guaranteed Loan Subsidy Expense by Program and Component
(in millions)

CURRENT REPORTING YEAR	Subsidy Expense for New Guaranteed Loans Disbursed					Reestimates			
	Interest Supple-ment	Defaults	Fees and Other Colls	Other	Total	Interest Rate	Technical	Total	GRAND TOTAL
Guaranteed Loan Programs									
Housing Loans	$ 8	$ 90	$ (46)	$ 0	$52	$ 40	$ (1)	$ 39	**$ 91**
Community Facility Loans	0	0	(1)	0	(1)	0	13	13	**12**
Electric Loans	0	0	0	0	0	0	0	0	**0**
Business & Industry Funds	0	55	(13)	0	42	8	49	57	**99**
Total Subsidy Expense, Guaranteed Loans	$ 8	$ 145	$(60)	$ 0	$93	$ 48	$ 61	$109	**$ 202**

PRIOR REPORTING YEAR	Subsidy Expense for New Guaranteed Loans Disbursed					Reestimates			
	Interest Supple-ment	Defaults	Fees and Other Colls	Other	Total	Interest Rate	Technical	Total	GRAND TOTAL
Guaranteed Loan Programs									
Housing Loans	$ 6	$130	$ (98)	$ 0	$38	$ 13	$ 58	$ 71	**$ 109**
Community Facility Loans	0	0	(1)	0	(1)	0	(2)	(2)	**(3)**
Electric Loans	0	0	0	0	0	0	0	0	**0**
Business & Industry Funds	0	42	(10)	0	32	13	75	88	**120**
Total Subsidy Expense, Guaranteed Loans	$ 6	$172	$(109)	$ 0	$69	$ 26	$ 131	$157	**$226**

Table 8

Guaranteed Loans Disbursed
(in millions)

	FY 2004		FY 2003	
Guaranteed Loans	**Principal, Face Value Disbursed**	**Principal, Guaranteed Disbursed**	**Principal, Face Value Disbursed**	**Principal, Guaranteed Disbursed**
Housing Loans	$ 3,420	$ 3,078	$ 2,992	$ 2,693
Community Facility Loans	135	116	138	117
Electric Loans	18	18	0	0
Business and Industry Loans	924	724	654	513
Water and Environmental Loans	4	3	3	2
Total Guaranteed Loans Disbursed	$ 4,501	$ 3,939	$ 3,787	$ 3,325

Credit Program Discussion and Descriptions

Rural Development offers direct and guaranteed loans through credit programs in the mission area through the Rural Housing Service (RHS), the Rural Business-Cooperative Service (RBS), and the Rural Utilities Service (RUS).

The Rural Development Mission Area

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

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

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

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

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

Rural Development List of Programs

Rural Housing Programs

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

Rural Business-Cooperative Programs

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

Rural Utilities Programs

Water and Environmental Direct Loans
Water and Environmental Guaranteed Loans
Electric Direct Loans
Electric Guaranteed Loans
Telecommunications Direct Loans
Rural Telephone Bank Direct Loans
Federal Financing Bank – Electric Guaranteed
Federal Financing Bank – Telecommunications Guaranteed
Distance Learning and Telemedicine Direct Broadband Telecommunications Services

Table 9a

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

Table 9b

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

Discussion of Administrative Expenses, Subsidy Costs, and Subsidy Rates

Administrative Expenses

Consistent with the Federal Credit Reform Act of 1990 as amended, subsidy cash flows exclude direct Federal administrative expenses. Administrative expenses for FY 2004 are shown in Table 10.

Table 10
Administrative Expenses (*in millions)*
FY 2004

Direct Loan Programs	Amount	Guaranteed Loan Programs	Amount
Total	**$282**	**Total**	**$159**

FY 2003

Direct Loan Programs	Amount	Guaranteed Loan Programs	Amount
Total	**$256**	**Total**	**$155**

Reestimates, Default Analysis, and Subsidy Rates

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

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

Rural Development's cashflow models are tailored for specific programs based on unique program characteristics. The models utilized are housing, guaranteed, and a direct model that covers the remaining portfolio with similar characteristics. Actual budgetary reestimates as of September 30, 2003, were recorded in the FY 2004 statements. One cohort, Electric Municipal loan program, also received an actual budgetary reestimate as of September 30, 2002. An approximator method was also used to estimate the FY 2004 reestimates for the major programs. The approximator method was also used for the FY 2003 major programs.

In FY 2003, the Direct Housing Program subsidy expense recorded the effect of a new model implementation. Therefore, comparability to FY 2004 subsidy expense is not feasible. The model for the remaining direct programs was implemented during FY 2001, the number of years since inception were inadequate to perform a meaningful trend analysis.

In FY 2004 and FY 2003, Rural Development guaranteed loan programs recorded prior year actual budgetary reestimates and current year activity estimates for material programs. A key sensitivity element in the guaranteed programs is defaults. Significant fluctuations to the subsidy expense compared to FY 2003 were not recorded. Since the guaranteed model was implemented during FY 2000, the number of years since inception was inadequate to perform a meaningful trend analysis.

Subsidy rates are used to compute each year's subsidy expenses as disclosed in tables 3 and 7. The subsidy rates disclosed below pertain only to the FY 2004 cohorts. These rates cannot be applied to the direct and guaranteed loans disbursed during the current reporting year to yield the subsidy expense. The subsidy expense for loans reported in the current year could result from disbursements of loans from both current year cohorts and prior year cohorts. The subsidy expense reported in the current year also includes reestimates.

Table 11

Subsidy Rates for Direct Loans (Percentage)

FY 2004

Direct Loan Programs	Interest Differential	Defaults	Fees and Other Colls.	Other	Total
Section 502 Single-Family Housing	-19.23	2.62	0.00	25.88	9.27
Section 504 Housing Repair	25.08	2.59	0.00	-0.21	27.46
Credit Sales Section 203 (SFH)	-21.54	1.22	0.00	2.86	-17.46
Section 514 Farm Labor Housing	42.74	0.03	0.00	-0.04	42.73
Section 515 Rural Rental Housing	-20.70	0.01	0.00	63.70	43.01
Section 523 Self-Help Housing Land Development	0.13	3.22	0.00	-0.27	3.08
Section 524 Housing Site Development	-4.76	3.37	0.00	1.36	-0.03
Credit Sales Section 209 (MFH)	-21.32	0.07	0.00	65.45	44.20
Modular Housing Loans					
Community Facilities	-0.48	0.19	0.00	-0.42	-0.71
Distance Learning and Telemedicine	0.00	0.00	0.00	0.00	0.00
Broadband	0.00	2.28	0.00	-0.10	2.18
Water and Environmental Disposal	3.56	0.09	0.00	-0.32	3.33
Electric Hardship	-2.27	0.03	0.00	-0.09	-2.33
Electric Municipal	-2.26	0.03	0.00	-0.19	-2.42
FFB Electric	-1.35	0.01	0.00	-0.65	-1.99
Electric Treasury	0.00	0.03	0.00	-0.09	0.06
Telephone Hardship	-4.49	0.02	0.00	0.03	-4.44
Telephone Treasury	0.00	0.04	0.00	0.01	0.05
FFB Telephone	-1.04	0.11	0.00	-0.92	-1.85
Rural Telephone Bank	-4.29	0.02	0.00	-0.05	-4.32
Intermediary Relending Program	43.27	0.00	0.00	0.00	43.27
Rural Economic Development	19.61	0.04	0.00	-1.04	18.61
Business and Industry	0.00	0.00	0.00	0.00	0.00
Broadband 4% Loan Program	2.79	2.15	0.00	0.00	4.94

FY 2003

Direct Loan Programs	Interest Differential	Defaults	Fees and Other Colls.	Other	Total
Section 502 Single-Family Housing	-12.90	2.68	0.00	29.59	19.37
Section 504 Housing Repair	28.98	2.27	0.00	-0.23	31.02
Credit Sales Section 203 (SFH)	-16.51	1.17	0.00	5.76	-9.58
Section 514 Farm Labor Housing	48.64	0.07	0.00	0.31	49.02
Section 515 Rural Rental Housing	-13.18	0.03	0.00	59.78	46.63
Section 523 Self-Help Housing Land Development	1.15	3.72	0.00	-0.46	4.41
Section 524 Housing Site Development	-4.02	3.92	0.00	1.19	1.09
Credit Sales Section 209 (MFH)	-13.12	0.03	0.00	59.77	46.68
Modular Housing Loans	21.03	-0.10	0.00	-3.01	17.92
Community Facilities	6.80	0.20	0.00	-0.76	6.24
Distance Learning and Telemedicine	0.41	0.00	0.00	-1.56	-1.15
Broadband	0.00	5.21	0.00	-0.05	5.16
Water and Environmental Disposal	11.77	0.10	0.00	-0.53	11.34
Electric Hardship	5.84	0.00	0.00	-0.13	5.71
Electric Municipal	4.46	0.00	0.00	-0.43	4.03
FFB Electric	-1.26	0.04	0.00	-0.60	-1.82
Electric Treasury	0.00	0.03	0.00	-0.07	-0.04
Telephone Hardship	1.71	0.00	0.00	0.00	1.71
Telephone Treasury	0.00	0.02	0.00	0.03	0.05
FFB Telephone	-1.09	0.13	0.00	-1.40	-2.36
Rural Telephone Bank	2.21	0.02	0.00	-0.85	1.38
Intermediary Relending Program	48.32	0.00	0.00	-0.06	48.26
Rural Economic Development	22.46	0.05	0.00	-1.15	21.36
Business and Industry	0.00	0.00	0.00	0.00	0.00

Table 12

Subsidy Rates for Loan Guarantees (Percentage)

FY 2004

Guaranteed Loan Programs	Interest Differential	Defaults	Fees and Other Colls.	Other	Total
Section 502 Single-Family Housing	0.00	3.07	-1.50	0.00	1.57
Section 502 Single-Family Housing - Refinance	0.00	0.79	-0.50	0.00	0.29
Section 538 Multi-Family Housing	9.61	0.56	-4.22	0.00	5.95
Community Facilities	0.00	0.23	-0.83	0.00	-0.60
Electric	0.00	0.06	0.00	0.00	0.06
Business and Industry	0.00	6.33	-1.48	0.01	4.86
NAD Bank	0.00	4.53	-1.59	0.00	2.94
Local TV	0.00	8.96	-0.50	0.00	8.46
Broadband Loans	0.00	3.90	0.00	0.00	3.90
Water and Waste	0.00	0.00	-0.90	0.00	-0.90

FY 2003

Guaranteed Loan Programs	Interest Differential	Defaults	Fees and Other Colls.	Other	Total
Section 502 Single-Family Housing	0.00	2.72	-2.00	0.00	0.72
Section 502 Single-Family Housing - Refinance	0.00	0.68	-0.50	0.00	0.18
Section 538 Multi-Family Housing	8.22	0.00	-3.72	0.00	4.50
Community Facilities	0.00	0.28	-0.82	0.00	-0.54
Electric	0.00	0.08	0.00	0.00	0.08
Business and Industry	0.00	5.45	-1.48	0.00	3.97
NAD Bank	0.00	6.15	-1.59	0.00	4.56

Other Disclosures

Foreclosed Property

Property is acquired largely through foreclosure and voluntary conveyance. Acquired properties associated with loans are reported at their market value at the time of acquisition. The projected future cash flows associated with acquired properties are used in determining the related allowance (at present value).

For FY's 2004 and 2003, Rural Housing Program properties consisted primarily of 783 and 952 rural single-family dwellings, respectively. The average holding period for single-family housing properties in inventory for FY's 2004 and 2003 was 24 months and 22 months, respectively. The approximate number of borrowers for which foreclosure proceedings were in process at the end of FY's 2004 and 2003 was 19,600 and 20,000, respectively. Certain properties can be leased to eligible individuals.

Commitments to Guarantee

As of September 30, 2004 and 2003, there were approximately $1.9 billion and $2.1 billion in commitments to extend loan guarantees, respectively.

Non-performing Loans

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

Interest Credit

Approximately $18.3 billion and $18.6 billion of the rural housing programs unpaid loan principal as of September 30, 2004 and 2003, respectively, was receiving interest credit. If those loans receiving interest credit had interest accrued at the full-unreduced rate, interest income would have been approximately $1.1 billion and $1.1 billion higher for FY's 2004 and 2003, respectively. At the end of FY's 2004 and 2003, the Rural Development portfolio contained approximately 88 thousand and 96 thousand restructured loans with an outstanding unpaid principal balance of $2.5 billion and $5.9 billion, respectively.

NOTE 7: GENERAL PROPERTY, PLANT AND EQUIPMENT, NET

Amounts are presented in millions.

This equipment generally represents computer hardware, software, and other office equipment used in the Rural Development mission area's network of offices. Refer to **Note 1J** for further information. The capitalization threshold for personal property was changed from $5,000 to $25,000 effective October 1, 2002.

FY 2004

Classes	Cost	Accumulated Depreciation	Book Value	Estimated Useful Life*	Method of Depreciation**	Capitalization Threshold
Personal Property						
Equipment	$ 11	$ 7	$ 4	1-5	SL	$ 25,000
Internal Use Software	53	7	46	2-15	SL	$ 100,000
Internal Use Software in Development	12	0	12	2-15	SL	$ 100,000
Total	$ 76	$ 14	$ 62			

FY 2003

Classes	Cost	Accumulated Depreciation	Book Value	Estimated Useful Life*	Method of Depreciation**	Capitalization Threshold
Personal Property						
Equipment	$ 11	$ 6	$ 5	1-5	SL	$ 25,000
Internal Use Software	32	5	27	2-15	SL	$ 100,000
Internal Use Software in Development	15	0	15	2-15	SL	$ 100,000
Total	$ 58	$ 11	$ 47			

* Range of Service Life

** SL – Straight Line

NOTE 8: OTHER ASSETS

Amounts are presented in millions.

	FY 2004	FY 2003
With the Public		
Investment in Loan Asset Sale Trust*	$ 35	$ 35
Other	2	2
Total Other Assets	$ 37	$ 37

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

NOTE 9: LIABILITIES NOT COVERED BY BUDGETARY RESOURCES

Amounts are presented in millions.

	FY 2004	FY 2003
Intragovernmental		
Unfunded FECA Liability	$ 6	$ 6
Total Intragovernmental	6	6
With the Public		
Federal Employee and Veterans' Benefits	32	34
Unfunded Annual Leave	36	26
Contingent Liability	0	8
Total Liabilities Not Covered by Budgetary Resources	74	74
Total Liabilities Covered by Budgetary Resources	62,222	60,369
Total Liabilities	$62,296	$ 60,443

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

NOTE 10: DEBT

Amounts are presented in millions.

	FY 2003 Beginning Balance	Net Borrowing	FY 2003 Ending Balance	Net Borrowing	FY 2004 Ending Balance
Agency Debt					
Held by the Public	$ 2	$ 0	$ 2	$ 0	$ 2
Notes Payable	82	(4)	78	(78)	0
Total Agency Debt	84	(4)	80	(78)	2
Other Debt					
Debt to the Treasury	27,513	(344)	27,169	1,802	28,971
Debt to the Federal Financing Bank (FFB)	22,379	321	22,700	(540)	22,160
Total Other Debt	49,892	(23)	49,869	1,262	51,131
Total Debt	$ 49,976	$ (27)	$49,949	$ 1,184	$ 51,133

	FY 2004	FY 2003
Classification of Debt		
Intragovernmental Debt	$ 51,131	$ 49,869
Debt Held by the Public	2	80
Total Debt	$ 51,133	$ 49,949

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

FFB CBO's are repaid as they mature and are not related to any particular group of loans. Borrowings made to finance loans directly between the borrower and FFB mature and are repaid as the related group of loans become due. Interest rates on the related group of loans are equal to interest rates on FFB borrowings, except in those situations in which an FFB-funded loan is restructured and the terms of the loan are modified. For FY's 2004 and 2003, there were approximately $1 million and $47 million of FFB loans repriced or refinanced, respectively.

In conjunction with certain rural utilities programs troubled debt restructurings, Rural Development has assumed notes payable to non-federal entities for FY's 2004 and 2003, approximating $ 0 million and $79 million, respectively, for debt previously guaranteed. These balances are owed to the National Rural Utilities Cooperative Finance Corporation, a private lender to rural electric borrowers

Supplemental information associated with debt follows:

Amounts are presented in millions.

	FY 2004	FY 2003
Interest Payable, Federal		
Federal Financing Bank	$ 49	$ 170
U.S. Treasury	0	1
Total	$ 49	$ 171

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

	FY 2004	FY 2003
Interest Expense, Federal		
Federal Financing Bank	$ 1,458	$ 1,616
U.S. Treasury	1,646	1,570
Total	$ 3,104	$ 3,186

NOTE 11: STOCK PAYABLE TO RTB BORROWERS

Amounts are presented in millions.

	FY 2004	FY 2003
With the Public		
B Stock Payable	$ 522	$ 572
C Stock Payable	821	737
Total	$ 1,343	$ 1,309

These liabilities are long-term in nature.

Capital Stock Class B:
Class B stock, a voting class of stock, is issued only to borrowers of RTB, in proportion to actual loan advances. RTB requires borrowers to purchase Class B stock in the amount of 5 percent of advanced loan amounts. Class B stock is nontransferable, except in connection with a transfer of ownership approved by RTB, of all or part of a RTB loan. A borrower may exchange Class B stock for Class C stock; 1) upon retiring all debt with RTB; or 2) effective November 9, 1999, prior to retiring all debt on a proportionate basis equal to the percentage of each note repaid. Otherwise, the borrower retains possession of the stock.

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

For further details regarding Class B & C Stock, see **Note 9, Capital Stock**, in the Rural Telephone Bank Financial Statements which are issued under separate cover.

NOTE 12: OTHER LIABILITIES

Amounts are presented in millions.

	FY 2004		
	Non-Current	**Current**	**Total**
Intragovernmental			
Employer Contributions & Payroll Taxes Payable	$ 0	$ 2	$ 2
Unfunded FECA Liability	0	6	6
Liability for Deposit Funds & Suspense Accounts	0	(2)	(2)
Other	0	7	7
Payable to Treasury General Fund	0	356	356
Total Intragovernmental	0	369	369
Other Accrued Liabilities	0	15	15
Dividends Payable	0	49	49
Liability for Deposit Funds and Suspense Accounts	0	85	85
Unfunded Annual Leave	0	36	36
Contingent Liability	0	0	0
Other	18	(11)	7
Total Other Liabilities	$ 18	$ 543	$ 561

	FY 2003		
	Non-Current	**Current**	**Total**
Intragovernmental			
Employer Contributions & Payroll Taxes Payable	$ 0	$ 2	$ 2
Unfunded FECA Liability	0	6	6
Liability for Deposit Funds & Suspense Accounts	0	(2)	(2)
Other	0	9	9
Payable to Treasury General Fund	0	465	465
Total Intragovernmental	0	480	480
Other Accrued Liabilities	0	0	0
Dividends Payable	0	28	28
Liability for Deposit Funds and Suspense Accounts	0	79	79
Unfunded Annual Leave	0	26	26
Contingent Liability	0	8	8
Other	18	2	20
Total Other Liabilities	$ 18	$ 623	$ 641

These liabilities are covered by Budgetary Resources.

NOTE 13: COMMITMENTS AND CONTINGENCIES

COMMITMENTS

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

As of September 30, 2004 and 2003, there were approximately $1.9 billion and $2.1 billion in commitments to extend loan guarantees, respectively.

As of September 30, 2004 and 2003, there were no obligations due to cancelled appropriations for which there is a contractual commitment for payment.

CONTINGENCIES

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

For cases in which payment has been deemed probable and for which the amount of potential liability has been estimated, $0 million and $8 million have been accrued in the Financial Statements as of September 30, 2004 and 2003, respectively.

Litigation is pending, due to a denial of payment by the Rural Business Program regarding a claim of loss on a series of previous loans made. A determination has been made by the Office of General Counsel that it is “reasonably possible” that an unfavorable outcome is likely to occur. The estimated range of potential loss is $2.0 million to $3.0 million.

Although overall the existing multiple family housing portfolio is in fair to good condition, Rural Development National Office officials, during a FY 2000 Management Control Review determined that adequate funds had not been accrued to address future maintenance costs. A conservative estimate is that in the next 5 years, approximately 4,250 properties and 85,000 apartment units, will physically deteriorate to the point where safety and sanitation will necessitate a general modernization program to maintain their marketability and ultimately compete for tenants. The cost is expected to reach into the hundreds of millions of dollars.

NOTE 14: SUPPORTING SCHEDULE FOR THE STATEMENT OF NET COST

Amounts are presented in millions.

	FY 2004					
	Mortgage Credit	**Housing Assistance**	**Area & Regional Development**	**Energy Supply & Conservation**	**Agricultural Research & Services**	**Consolidated Total**
Intragovernmental Gross Costs:						
Benefit Program Costs	$ 42	$ 4	$ 17	$ 5	$ 0	$ 68
Imputed Costs	60	6	25	7	0	98
Reimbursable Costs	41	4	19	5	0	69
Borrowing Interest Expense	857	0	562	1,685	0	3,104
Total Intragovernmental Gross Cost	1,000	14	623	1,702	0	3,339
Less: Intragovernmental Earned Revenue **(Note 15)**	129	1	146	73	0	349
Intragovernmental Net Costs	871	13	477	1,629	0	2,990
Gross Costs with the Public:						
Grants	0	875	815	0	2	1,692
Loan Cost Subsidies	275	10	168	(153)	0	300
Indemnities	(5)	0	(2)	(1)	0	(8)
Other	273	29	188	(67)	0	423
Total Gross Costs with the Public	543	914	1,169	(221)	2	2,407
Less: Earned Revenues from the Public **(Note 15)**	1,279	0	625	1,716	0	3,620
Net Costs with the Public	(736)	914	544	(1,937)	2	(1,213)
NET COST OF OPERATIONS	$ 135	$ 927	1,021	$ (308)	$ 2	$ 1,777

	FY 2003					
	Mortgage Credit	**Housing Assistance**	**Area & Regional Development**	**Energy Supply & Conservation**	**Agricultural Research & Services**	**Consolidated Total**
Intragovernmental Gross Costs:						
Benefit Program Costs	$ 39	$ 4	$ 16	$ 5	$ 0	$ 64
Imputed Costs	58	5	25	7	0	95
Reimbursable Costs	39	4	16	5	0	64
Borrowing Interest Expense	892	0	586	1,708	0	3,186
Total Intragovernmental Gross Cost	1,028	13	643	1,725	0	3,409
Less: Intragovernmental Earned Revenue **(Note 15)**	101	1	141	79	0	322
Intragovernmental Net Costs	927	12	502	1,646	0	3,087
Gross Costs with the Public:						
Grants	1	793	732	0	4	1,530
Loan Cost Subsidies	153	2	225	475	0	855
Indemnities	5	0	2	1	0	8
Other	1,217	28	601	411	0	2,257
Total Gross Costs with the Public	1,376	823	1,560	887	4	4,650
Less: Earned Revenues from the Public **(Note 15)**	1,482	0	607	1,909	0	3,998
Net Costs with the Public	(106)	823	953	(1,022)	4	652
NET COST OF OPERATIONS	$ 821	$ 835	$ 1,455	$ 624	$ 4	$ 3,739

OTHER DISCLOSURES

FUNCTION LEVEL TITLE	SUBFUNCTION LEVEL TITLE	BUDGET SUBFUNCTION CODE	ACTIVITY INCLUDED IN FINANCIAL STATEMENTS (where applicable)	LOAN/GRANT PROGRAMS INCLUDED IN BUDGET SUBFUNCTION CODE
National Defense	Department of Defense – Military	051	Other	Armament Retooling & Support
Energy	Energy Supply & Conservation	271 272	Rural Utilities Programs	Rural Electric & Telecommunications
National Resources	Water Resources Conservation & Land Management Pollution Control & Abatement	301 302 304	Other	Hazardous Waste Disposal
Agriculture	Agricultural Research & Services	352	Rural Business Programs	Conservation Loan
Commerce & Housing	Mortgage Credit	371	Rural Housing Programs	Single Family Housing (Direct & Guaranteed) Multi-Family Housing (Direct & Guaranteed)
Community & Regional Development	Area & Regional Development	452	Rural Housing Programs Rural Business Programs Rural Utilities Programs	Rural Community Facility (Direct & Guaranteed) Rural Business & Industry (Direct & Guaranteed) Rural Economic Development (Loans & Grants) Rural Development Loan Funds Rural Water & Environmental (Direct & Guaranteed) Rural Telephone Bank Distance Learning &Telemedicine
Income Security	Housing Assistance	604	Rural Housing Programs	Domestic Farm Labor Grants Very Low-Income Housing Repair Grants Construction Defects Rental Assistance Program Other Housing Grants

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

NOTE 15: EARNED REVENUES

Amounts are presented in millions.

FY 2004

	Mortgage Credit	Housing Assistance	Area & Regional Development	Energy Supply & Conservation	Total
With the Public					
Interest Revenue	$ 1,256	$ 0	$ 618	$ 1,716	$ 3,590
Other	23	0	7	0	30
Total	$ 1,279	$ 0	$ 625	$ 1,716	$ 3,620
Intragovernmental					
Interest Revenue from Treasury	$ 121	$ 0	$ 143	$ 72	$ 336
Other	8	1	3	1	13
Total	129	1	146	73	349
Total Earned Revenues	$ 1,408	$ 1	$ 771	$ 1,789	$ 3,969

FY 2003

	Mortgage Credit	Housing Assistance	Area & Regional Development	Energy Supply & Conservation	Total
With the Public					
Interest Revenue	$ 1,482	$ 0	$ 607	$ 1,909	$ 3,998
Other	0	0	0	0	0
Total	$ 1,482	$ 0	$ 607	$ 1,909	$ 3,998
Intragovernmental					
Interest Revenue from Treasury	$ 93	$ 0	$ 139	$ 78	$ 310
Other	7	1	3	1	12
Total	100	1	142	79	322
Total Earned Revenues	$ 1,582	$ 1	$ 749	$ 1,988	$ 4,320

Other Disclosures

Credit Reform

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

Exchange Transactions With Non-Federal Sources

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

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

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

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

Exchange Transactions with Federal Sources
Rural Development serves as a temporary source of supervised credit until borrowers are able to qualify for private sector resources. As the lender of last resort, Rural Development is unable to recoup all the costs associated with its loan making and loan servicing activities. The main reason is that the costs associated with borrowings from Treasury to make loans exceed the interest income received from borrowers plus any interest income earned from Treasury.

NOTE 16: APPORTIONMENT CATEGORIES OF OBLIGATIONS INCURRED

Amounts are presented in millions.

	FY 2004		
	Direct	**Reimbursable**	**Total**
Category A	$ 10,466	$ 0	$ 10,466
Category B	5,295	509	5,804
Total Obligations Incurred	$ 15,761	$ 509	$ 16,270

	FY 2003		
	Direct	**Reimbursable**	**Total**
Category A	$ 10,358	$ 0	$ 10,358
Category B	4,578	487	5,065
Total Obligations Incurred	$ 14,936	$ 487	$ 15,423

NOTE 17: AVAILABLE BORROWING AUTHORITY, END OF PERIOD

As of September 30, 2004 and 2003, the amount of available borrowing authority was $17.0 billion and $15.0 billion, respectively.

NOTE 18: TERMS OF BORROWING AUTHORITY USED

Requirements for repayments of borrowings: Borrowings are repaid on SF 1151, Nonexpenditure Transfer Authorization, as maturity dates become due. For liquidating accounts, maturity dates are one working day prior to the anniversary date of the note. For financing accounts, maturity dates are based on the period of time used in the subsidy calculation, not the contractual term of the agency's loans to borrowers. This period of time used in the subsidy calculation will normally be longer than the contractual term of the agency's loans to borrowers.

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

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

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

NOTE 19: PERMANENT INDEFINITE APPROPRIATIONS

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

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

No-year authority remains available for obligation for an indefinite period of time, usually until the objectives for which the authority was made available are achieved.

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

NOTE 20: LEGAL ARRANGEMENTS AFFECTING USE OF UNOBLIGATED BALANCES

The availability/use of budget authority (i.e., unobligated balances) for obligation and expenditure are limited by purpose, amount, and time.

- **Purpose –** Funds may be obligated and expended only for the purpose authorized in appropriation acts or other laws.

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

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

The time limitations on the use of unobligated balances are the same as those previously discussed in the last two paragraphs of the permanent indefinite appropriations footnote disclosure **(Note 19).**

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

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

The 2006 Budget of the United States Government, with the Actual Column completed for FY 2004, has not yet been published as of the date of these financial statements. The Budget is currently expected to be published and delivered to Congress in early February 2005. The Budget will be available from the Government Printing Office.

The 2005 Budget of the United States Government, with the Actual Columns completed for FY 2003, was published in February 2004 and reconciled to the SBR. A reporting error of $5 million was noted. The error is a result of a document processed to change our FACTS II information after the FY 2003 Financial Statements were published. Legitimate differences did occur as described in the table below. The legitimate differences represent:

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

- Shared accounts, which represent designated fund account symbols by the United States Department of Agriculture to receive and subsequently obligate and disburse and allot are treated as nonexpenditure transactions. These accounts retain the fund account symbol identified with the original appropriation from which monies were advanced.

- Amounts due to rounding.

Reconciliation Between FY 2003 Statement of Budgetary Resources and the President's Budget

Amounts are presented in millions.

Applicable Line From SBR	**Amount from SBR**	**Applicable Line From President's Budget**	**Amount From President's Budget**	**Legitimate Differences**	**Reporting Errors**
Total Budgetary Resources (line 7)	$19,112	Total budgetary resources available for obligation	$18,970	T - $142 E - 137 S - 1 R - (1)	T = $5
Total Status of Budgetary Resources (line 11)	$19,112	Total new obligations, Unobligated balance expiring/withdrawn, Unobligated balance carried forward, end of year, and Unobligated balance available, end of year	$18,973	T - $139 E - 137 R - (4) S 1	T = $5
Outlays (line 15)	$ 2,535	Outlays	$ 2,533	T - $ 2 R - (2) S - 4	None

LEGEND

T = Total Amount
E = Expired Budgetary Authority
R = Rounding
S = Shared Accounts

NOTE 22: EXPLANATION OF RELATIONSHIP BETWEEN LIABILITIES NOT COVERED BY BUDGETARY RESOURCES ON THE BALANCE SHEET AND THE CHANGE IN COMPONENTS REQUIRING OR GENERATING RESOURCES IN FUTURE PERIODS ON THE STATEMENT OF FINANCING

	FY 2004	FY 2003
Current Year Liabilities Not Covered by Budgetary Resources, as Disclosed in **Note 9**	$ 74	$ 74
Prior Year Liabilities Not Covered by Budgetary Resources	(74)	(70)
Increase (Decrease) in Liabilities Not Covered by Budgetary Resources	0	4
Upward/Downward Reestimates of Credit Subsidy Expense	(124)	418
Increase in Exchange Revenue Receivable from the Public	0	0
Other	(3)	(4)
Components Requiring or Generating Resources in Future Periods, as Reported on the Statement of Financing	$ (127)	$ 418

For FY 2004, the $(3) million amount reported as "Other" above is different from the amount reported as "Other" on the Statement of Financing due to the inclusion of $3 million applicable to the increase in annual leave liability on the Statement of Financing.

For FY 2003, the $(4) million amount reported as "Other" above is different from the amount reported as "Other" on the Statement of Financing due to the inclusion of $4 million reported above on the line titled "Increase (Decrease) in Liabilities Not Covered by Budgetary Resources", in the overall computation.

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

NOTE 23: DESCRIPTION OF TRANSFERS THAT APPEAR AS A RECONCILING ITEM ON THE STATEMENT OF FINANCING

The Appalachian Regional Commission (ARC) invests in the basic building blocks of sustainable economic development in the 406 counties (13-State Region) which comprise the Appalachian Region. ARC has allocated funds to Rural Development to provide accounting services. As of September 30, 2004 and 2003, the amount of this reconciling item is $14.4 million and $15.5 million, respectively.

The Economic Development Administration's (EDA) Assistance Program provides grants for public works facilities, other financial assistance, and planning and coordination assistance needed to alleviate conditions of substantial and persistent unemployment and underemployment in economically distressed areas and regions. EDA has allocated funds to Rural Development to provide accounting services. As of September 30, 2004 and 2003, the amount of this reconciling item is $6.4 million and $5.9 million, respectively.

NOTE 24: INCIDENTAL CUSTODIAL COLLECTIONS

Amounts are presented in millions.

	Custodial Activity	
	FY 2004	**FY 2003**
Sources of Collections		
Soil Conservation Service Loan Collections	$ 2	$ 1
Total Revenue Collected	$ 2	$ 1
Disposition of Collections		
Amount Transferred to Treasury Receipt Accounts	$ 2	$ 1
Total Disposition of Revenue	$ 2	$ 1
Net Custodial Activity	$ 0	$ 0

REQUIRED SUPPLEMENTARY INFORMATION

Amounts are presented in millions

	2004 Budgetary		2004 Non-Budgetary Credit Program Financing Accounts		2003 Budgetary		2003 Non-Budgetary Credit Program Financing Accounts	
	Rural Community Advancement Program		Rural Community Advancement Program		Rural Community Advancement Program		Rural Community Advancement Program	
Budgetary Resources:								
Budget Authority								
Appropriations Received	$	1,159	$	0	$	1,404	$	0
Borrowing Authority		0		1,587		0		994
Net Transfers		0		0		23		0
Unobligated Balance:								
Beginning of Period		249		385		180		243
Net Transfers, Actual		0		0		0		0
Spending Authority from Offsetting Collections:								
Earned								
Collected		474		999		495		1,032
Receivable from Federal Sources		0		(3)		0		3
Change in Unfilled Customer Orders								
Without Advance from Federal Sources		0		(65)		0		(5)
Subtotal		474		931		495		1,030
Recoveries of Prior Year Obligations		117		237		23		136
Permanently Not Available		(688)		(364)		(624)		(378)
Total Budgetary Resources	$	1,311	$	2,776	$	1,501	$	2,025
Status of Budgetary Resources								
Obligations Incurred:								
Direct	$	1,062	$	2,266	$	1,252	$	1,640
Reimbursables		0		0		0		0
Subtotal		1,062		2,266		1,252		1,640
Unobligated Balance:								
Apportioned		168		510		169		355
Unobligated Balance Not Available		81		0		80		30
Total Status of Budgetary Resources	$	1,311	$	2,776	$	1,501	$	2,025
Relationship of Obligations to Outlays:								
Obligated Balance, Net, Beginning of Period		2,835		2,914		2,682		2,932
Obligated Balance Transferred, Net		0		0		0		0
Obligated Balance, Net, End of Period:								
Accounts Receivable		0		0		0		(3)
Unfilled Customer Orders from Federal Resources		0		(241)		0		(306)
Undelivered Orders		2,697		3,609		2,757		3,223
Accounts Payable		38		0		78		0
Outlays:								
Disbursements		1,045		1,643		1,076		1,526
Collections		(474)		(999)		(496)		(1,032)
Subtotal		571		644		580		494
Less: Offsetting Receipts		140		0		37		0
Net Outlays	$	431	$	644	$	543	$	494

REQUIRED SUPPLEMENTARY INFORMATION

Amounts are presented in millions	2004 Budgetary	2004 Non-Budgetary Credit Program Financing Accounts	2003 Budgetary	2003 Non-Budgetary Credit Program Financing Accounts
	Rural Electrification/ Telecommunication Funds	Rural Electrification/ Telecommunication Funds	Rural Electrification/ Telecommunication Funds	Rural Electrification/ Telecommunication Funds
Budgetary Resources:				
Budget Authority				
Appropriations Received	$ 391	$ 0	$ 193	$ 0
Borrowing Authority	2	4,444	0	4,418
Net Transfers	20	0	22	0
Unobligated Balance:				
Beginning of Period	375	10	90	362
Net Transfers, Actual	0	0	0	0
Spending Authority from Offsetting Collections:				
Earned				
Collected	3,060	1,621	3,350	1,256
Receivable from Federal Sources	0	0	0	0
Change in Unfilled Customer Orders				
Without Advance from Federal Sources	0	(12)	0	(5)
Subtotal	3,060	1,609	3,350	1,251
Recoveries of Prior Year Obligations	20	125	4	32
Permanently Not Available	(804)	(675)	(2,093)	(746)
Total Budgetary Resources	$ 3,064	$ 5,513	$ 1,566	$ 5,317
Status of Budgetary Resources				
Obligations Incurred:				
Direct	$ 1,319	$ 5,298	$ 1,191	$ 5,307
Reimbursables	0	0	0	0
Subtotal	1,319	5,298	1,191	5,307
Unobligated Balance:				
Apportioned	88	215	0	0
Unobligated Balance Not Available	1,657	0	375	10
Total Status of Budgetary Resources	$ 3,064	$ 5,513	$ 1,566	$ 5,317
Relationship of Obligations to Outlays:				
Obligated Balance, Net, Beginning of Period	384	9,501	380	8,315
Obligated Balance Transferred, Net	0	0	0	0
Obligated Balance, Net, End of Period:				
Accounts Receivable	0	0	0	0
Unfilled Customer Orders from Federal Resources	0	(50)	0	(62)
Undelivered Orders	247	10,898	269	9,561
Accounts Payable	71	0	115	2
Outlays:				
Disbursements	1,365	3,838	1,182	4,095
Collections	(3,060)	(1,621)	(3,350)	(1,256)
Subtotal	(1,695)	2,217	(2,168)	2,839
Less: Offsetting Receipts	62	0	70	0
Net Outlays	$ (1,757)	$ 2,217	$ (2,238)	$ 2,839

REQUIRED SUPPLEMENTARY INFORMATION

Amounts are presented in millions	2004 Budgetary	2004 Non-Budgetary Credit Program Financing Accounts	2003 Budgetary	2003 Non-Budgetary Credit Programs Financing Accounts
	Rural Telephone Bank Funds	**Rural Telephone Bank Funds**	**Rural Telephone Bank Funds**	**Rural Telephone Bank Funds**
Budgetary Resources:				
Budget Authority				
Appropriations Received	$ 4	$ 0	$ 7	$ 0
Borrowing Authority	0	216	0	169
Net Transfers	(20)	0	(22)	0
Unobligated Balance:				
Beginning of Period	1,202	1	945	17
Net Transfers, Actual	0	0	0	0
Spending Authority from Offsetting Collections:				
Earned				
Collected	203	61	247	94
Receivable from Federal Sources	(50)	0	56	0
Change in Unfilled Customer Orders				
Without Advance from Federal Sources	0	(2)	0	1
Subtotal	153	59	303	95
Recoveries of Prior Year Obligations	16	76	14	32
Permanently Not Available	(11)	(110)	(10)	(116)
Total Budgetary Resources	$ 1,344	$ 242	$ 1,237	$ 197
Status of Budgetary Resources				
Obligations Incurred:				
Direct	$ 53	$ 212	$ 35	$ 196
Reimbursables	0	0	0	0
Subtotal	53	212	35	196
Unobligated Balance:				
Apportioned	0	0	0	0
Unobligated Balance Not Available	1,291	30	1,202	1
Total Status of Budgetary Resources	$ 1,344	$ 242	$ 1,237	$ 197
Relationship of Obligations to Outlays:				
Obligated Balance, Net, Beginning of Period	53	1,169	117	1,091
Obligated Balance Transferred, Net	0	0	0	0
Obligated Balance, Net, End of Period:				
Accounts Receivable	(6)	0	(57)	0
Unfilled Customer Orders from Federal Resources	0	(18)	0	(20)
Undelivered Orders	64	1,223	82	1,189
Accounts Payable	48	0	28	0
Outlays:				
Disbursements	34	102	29	84
Collections	(203)	(61)	(247)	(94)
Subtotal	(169)	41	(218)	(10)
Less: Offsetting Receipts	11	0	4	0
Net Outlays	$ (180)	$ 41	$ (222)	$ (10)

REQUIRED SUPPLEMENTARY INFORMATION

Amounts are presented in millions

	2004 Budgetary	2004 Non-Budgetary Credit Program Financing Accounts	2003 Budgetary	2003 Non-Budgetary Credit Program Financing Accounts
	Rural Housing Funds	**Rural Housing Funds**	**Rural Housing Funds**	**Rural Housing Funds**
Budgetary Resources:				
Budget Authority				
Appropriations Received	$ 858	$ 0	$797	$ 0
Borrowing Authority	0	1,557	0	1,673
Net Transfers	0	0	1	0
Unobligated Balance:				
Beginning of Period	261	980	63	431
Net Transfers, Actual	4	0	0	0
Spending Authority from Offsetting Collections:				
Earned				
Collected	1,577	2,194	1,779	2,029
Receivable from Federal Sources	0	0	0	0
Change in Unfilled Customer Orders				
Without Advance from Federal Sources	0	(31)	0	54
Subtotal	1,577	2,163	1,779	2,083
Recoveries of Prior Year Obligations	26	91	88	78
Permanently Not Available	(1,365)	(1,152)	(1,267)	(528)
Total Budgetary Resources	$ 1,361	$ 3,639	$ 1,461	$ 3,737
Status of Budgetary Resources				
Obligations Incurred:				
Direct	$ 1,149	$ 2,598	$ 1,200	$ 2,758
Reimbursables	0	0	0	0
Subtotal	1,149	2,598	1,200	2,758
Unobligated Balance:				
Apportioned	13	690	14	683
Unobligated Balance Not Available	199	351	247	296
Total Status of Budgetary Resources	$ 1,361	$ 3,639	$ 1,461	$ 3,737
Relationship of Obligations to Outlays:				
Obligated Balance, Net, Beginning of Period	359	560	412	551
Obligated Balance Transferred, Net	0	0	0	0
Obligated Balance, Net, End of Period:				
Accounts Receivable	0	0	0	0
Unfilled Customer Orders from Federal Resources	0	(240)	0	(271)
Undelivered Orders	230	943	243	831
Accounts Payable	35	0	116	0
Outlays:				
Disbursements	1,217	2,395	1,164	2,617
Collections	(1,577)	(2,194)	(1,778)	(2,029)
Subtotal	(360)	201	(614)	588
Less: Offsetting Receipts	167	0	673	0
Net Outlays	$ (527)	$ 201	$ (1,287)	$ 588

REQUIRED SUPPLEMENTARY INFORMATION

Amounts are presented in millions

	2004 Budgetary	2004 Non-Budgetary Credit Program Financing Accounts	2003 Budgetary	2003 Non-Budgetary Credit Program Financing Accounts
	Rental Assistance Programs	**Rental Assistance Programs**	**Rental Assistance Programs**	**Rental Assistance Programs**
Budgetary Resources:				
Budget Authority				
Appropriations Received	$ 647	$ 0	$ 788	$ 0
Borrowing Authority	0	0	0	0
Net Transfers	0	0	0	0
Unobligated Balance:				
Beginning of Period	2	0	4	0
Net Transfers, Actual	0	0	0	0
Spending Authority from Offsetting Collections:				
Earned				
Collected	0	0	0	0
Receivable from Federal Sources	0	0	0	0
Change in Unfilled Customer Orders				
Without Advance from Federal Sources	0	0	0	0
Subtotal	0	0	0	0
Recoveries of Prior Year Obligations	1	0	1	0
Permanently Not Available	(67)	0	(67)	0
Total Budgetary Resources	$ 583	$ 0	$ 726	$ 0
Status of Budgetary Resources				
Obligations Incurred:				
Direct	$ 581	$ 0	$ 724	$ 0
Reimbursables	0	0	0	0
Subtotal	581	0	724	0
Unobligated Balance:				
Apportioned	0	0	0	0
Unobligated Balance Not Available	2	0	2	0
Total Status of Budgetary Resources	$ 583	$ 0	$ 726	$ 0
Relationship of Obligations to Outlays:				
Obligated Balance, Net, Beginning of Period	2,793	0	2,789	0
Obligated Balance Transferred, Net	0	0	0	0
Obligated Balance, Net, End of Period:				
Accounts Receivable	0	0	0	0
Unfilled Customer Orders from Federal Resources	0	0	0	0
Undelivered Orders	2,531	0	2,747	0
Accounts Payable	64	0	46	0
Outlays:				
Disbursements	778	0	720	0
Collections	0	0	0	0
Subtotal	778	0	720	0
Less: Offsetting Receipts	0	0	0	0
Net Outlays	$ 778	$ 0	$ 720	$ 0

REQUIRED SUPPLEMENTARY INFORMATION

Amounts are presented in millions

	2004 Budgetary	2004 Non-Budgetary Credit Program Financing Accounts	2003 Budgetary	2003 Non-Budgetary Credit Program Financing Accounts
	Rural Housing Grants	**Rural Housing Grants**	**Rural Housing Grants**	**Rural Housing Grants**
Budgetary Resources:				
Budget Authority				
Appropriations Received	$ 117	$ 0	$ 114	$ 0
Borrowing Authority	0	0	0	0
Net Transfers	0	0	(2)	0
Unobligated Balance:				
Beginning of Period	24	0	42	0
Net Transfers, Actual	(4)	0	0	0
Spending Authority from Offsetting Collections:				
Earned				
Collected	0	0	0	0
Receivable from Federal Sources	0	0	0	0
Change in Unfilled Customer Orders				
Without Advance from Federal Sources	0	0	0	0
Subtotal	0	0	0	0
Recoveries of Prior Year Obligations	6	0	4	0
Permanently Not Available	(1)	0	(12)	0
Total Budgetary Resources	$ 142	$ 0	$ 146	$ 0
Status of Budgetary Resources				
Obligations Incurred:				
Direct	$ 113	$ 0	$ 122	$ 0
Reimbursables	0	0	0	0
Subtotal	113	0	122	0
Unobligated Balance:				
Apportioned	29	0	24	0
Unobligated Balance Not Available	0	0	0	0
Total Status of Budgetary Resources	$ 142	$ 0	$ 146	$ 0
Relationship of Obligations to Outlays:				
Obligated Balance, Net, Beginning of Period	170	0	134	0
Obligated Balance Transferred, Net	0	0	0	0
Obligated Balance, Net, End of Period:				
Accounts Receivable	0	0	0	0
Unfilled Customer Orders from Federal Resources	0	0	0	0
Undelivered Orders	182	0	168	0
Accounts Payable	2	0	2	0
Outlays:				
Disbursements	93	0	82	0
Collections	0	0	0	0
Subtotal	93	0	82	0
Less: Offsetting Receipts	0	0	0	0
Net Outlays	$ 93	$ 0	$ 82	$ 0

REQUIRED SUPPLEMENTARY INFORMATION

Amounts are presented in millions	2004 Budgetary	2004 Non-Budgetary Credit Program Financing Accounts	2003 Budgetary	2003 Non-Budgetary Credit Program Financing Accounts
	Salaries & Expense	**Salaries & Expense**	**Salaries & Expense**	**Salaries & Expense**
Budgetary Resources:				
Budget Authority				
Appropriations Received	$ 144	$ 0	$ 146	$ 0
Borrowing Authority	0	0	0	0
Net Transfers	0	0	0	0
Unobligated Balance:				
Beginning of Period	37	0	45	0
Net Transfers, Actual	0	0	0	0
Spending Authority from Offsetting Collections:				
Earned				
Collected	501	0	491	0
Receivable from Federal Sources	(1)	0	(4)	0
Change in Unfilled Customer Orders				
Without Advance from Federal Sources				
Subtotal	500	0	487	0
Recoveries of Prior Year Obligations	117	0	50	0
Permanently Not Available	(13)	0	(18)	0
Total Budgetary Resources	$ 785	$ 0	$ 710	$ 0
Status of Budgetary Resources				
Obligations Incurred:				
Direct	$ 240	$ 0	$ 186	$ 0
Reimbursables	509	0	487	0
Subtotal	749	0	673	0
Unobligated Balance:				
Apportioned	(5)	0	3	0
Unobligated Balance Not Available	41	0	34	0
Total Status of Budgetary Resources	$ 785	$ 0	$ 710	$ 0
Relationship of Obligations to Outlays:				
Obligated Balance, Net, Beginning of Period	131	0	126	0
Obligated Balance Transferred, Net				
Obligated Balance, Net, End of Period:				
Accounts Receivable	0	0	(1)	0
Unfilled Customer Orders from Federal Resources				
Undelivered Orders	106	0	109	0
Accounts Payable	25	0	23	0
Outlays:				
Disbursements	633	0	622	0
Collections	(501)	0	(491)	0
Subtotal	132	0	131	0
Less: Offsetting Receipts	0	0	0	0
Net Outlays	$ 132	$ 0	$ 131	$ 0

REQUIRED SUPPLEMENTARY INFORMATION

Amounts are presented in millions	2004 Budgetary	2004 Non-Budgetary Credit Program Financing Accounts	2003 Budgetary	2003 Non-Budgetary Credit Program Financing Accounts
	Other	Other	Other	Other
Budgetary Resources:				
Budget Authority				
Appropriations Received	$ 137	$ 0	$ 96	$ 0
Borrowing Authority	0	676	0	122
Net Transfers	3	0	60	0
Unobligated Balance:				
Beginning of Period	148	15	118	23
Net Transfers, Actual	0	0	0	0
Spending Authority from Offsetting Collections:				
Earned				
Collected	37	68	20	60
Receivable from Federal Sources	36	(1)	17	1
Change in Unfilled Customer Orders				
Without Advance from Federal Sources	0	14	0	3
Subtotal	73	81	37	64
Recoveries of Prior Year Obligations	6	14	9	68
Permanently Not Available	(32)	(45)	(10)	(98)
Total Budgetary Resources	$ 335	$ 741	$ 310	$ 179
Status of Budgetary Resources				
Obligations Incurred:				
Direct	$ 148	$ 722	$ 162	$ 163
Reimbursables	0	0	0	0
Subtotal	148	722	162	163
Unobligated Balance:				
Apportioned	103	19	107	5
Unobligated Balance Not Available	84	0	41	11
Total Status of Budgetary Resources	$ 335	$ 741	$ 310	$ 179
Relationship of Obligations to Outlays:				
Obligated Balance, Net, Beginning of Period	191	245	133	268
Obligated Balance Transferred, Net	0	0	0	0
Obligated Balance, Net, End of Period:				
Accounts Receivable	(72)	0	(36)	(1)
Unfilled Customer Orders from Federal Resources	0	(69)	0	(55)
Undelivered Orders	262	874	224	301
Accounts Payable	2	0	3	0
Outlays:				
Disbursements	105	135	79	112
Collections	(37)	(68)	(20)	(60)
Subtotal	68	67	59	52
Less: Offsetting Receipts	7	0	6	0
Net Outlays	$ 61	$ 67	$ 53	$ 52

REQUIRED SUPPLEMENTARY INFORMATION

Amounts are presented in millions	2004 Budgetary Total	2004 Non-Budgetary Credit Program Financing Accounts Total	2003 Budgetary Total	2003 Non-Budgetary Credit Program Financing Accounts Total
Budgetary Resources:				
Budget Authority				
Appropriations Received	$ 3,457	$ 0	$ 3,545	$ 0
Borrowing Authority	2	8,480	0	7,376
Net Transfers	3	0	82	0
Unobligated Balance:				
Beginning of Period	2,298	1,391	1,487	1,076
Net Transfers, Actual	0	0	0	0
Spending Authority from Offsetting Collections:				
Earned				
Collected	5,852	4,943	6,382	4,471
Receivable from Federal Sources	(15)	(4)	69	4
Change in Unfilled Customer Orders				
Without Advance from Federal Sources	0	(96)	0	48
Subtotal	5,837	4,843	6,451	4,523
Recoveries of Prior Year Obligations	309	543	193	346
Permanently Not Available	(2,981)	(2,346)	(4,101)	(1,866)
Total Budgetary Resources	$ 8,925	$ 12,911	$ 7,657	$ 11,455
Status of Budgetary Resources				
Obligations Incurred:				
Direct	$ 4,665	$ 11,096	$ 4,872	$ 10,064
Reimbursables	509	0	487	0
Subtotal	5,174	11,096	5,359	10,064
Unobligated Balance:				
Apportioned	396	1,434	317	1,043
Unobligated Balance Not Available	3,355	381	1,981	348
Total Status of Budgetary Resources	$ 8,925	$ 12,911	$ 7,657	$ 11,455
Relationship of Obligations to Outlays:				
Obligated Balance, Net, Beginning of Period	6,916	14,389	6,773	13,157
Obligated Balance Transferred, Net	0	0	0	0
Obligated Balance, Net, End of Period:				
Accounts Receivable	(78)	0	(94)	(4)
Unfilled Customer Orders from Federal Resources	0	(618)	0	(714)
Undelivered Orders	6,319	17,547	6,599	15,105
Accounts Payable	285	0	411	2
Outlays:				
Disbursements	5,270	8,113	4,954	8,434
Collections	(5,852)	(4,943)	(6,382)	(4,471)
Subtotal	(582)	3,170	(1,428)	3,963
Less: Offsetting Receipts	387	0	790	0
Net Outlays	$ (969)	$ 3,170	$ (2,218)	$ 3,963

ACRONYMS USED

ARC	Appalachian Regional Commission
A/R	Accounts Receivable
CBO	Certificates of Beneficial Ownership
EDA	Economic Development Administration
FACTS	Treasury Federal Agencies Centralized Trial Balance System
FASAB	Federal Accounting Standards Advisory Board
FECA	Federal Employees Compensation Act
FFB	Federal Financing Bank
GSA	General Services Administration
MFH	Multi-Family Housing
NAD	North American Development
OMB	Office of Management and Budget
PP&E	Property, Plant and Equipment
RBS	Rural Business-Cooperative Service
RDIF	Rural Development Insurance Fund
RHIF	Rural Housing Insurance Fund
RHS	Rural Housing Service
RTB	Rural Telephone Bank
RUS	Rural Utilities Service
SBR	Statement of Budgetary Resources
SFFAS	Statements of Federal Financial Accounting Standards
SFH	Single Family Housing
USDA	United States Department of Agriculture