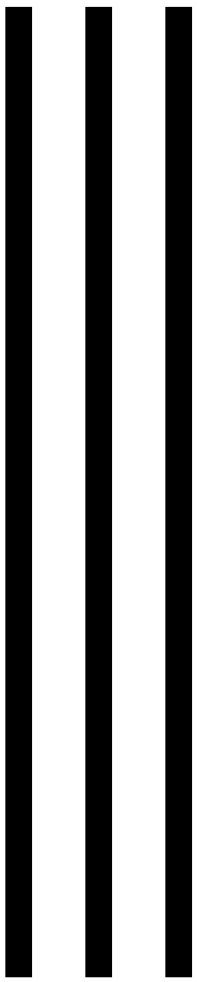



# U.S. Department of Agriculture
## Office of Inspector General
## Headquarters
## Audit Report

Rural Utilities Service
Sale of Capital Assets
by RUS Cooperatives

**Report No.**
**09001-1-HQ**
**September 2002**

UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250

DATE: September 27, 2002

REPLY TO
ATTN OF: 09001-1-HQ

SUBJECT: Rural Utilities Service – Sale of Capital Assets by RUS Cooperatives

TO: Hilda Gay Legg
Administrator
Rural Utilities Service

THROUGH: Sherie Hinton Henry
Director
Financial Management Division

This report presents the results of the subject audit. Your agency's May 22, 2002, response to the draft report is included as Exhibit B. Excerpts of your response along with the Office of Inspector General's (OIG) position have been incorporated into the Agency Comments and OIG Position sections of the report.

Based upon your response, we have reached management decision for both of the report's recommendations. Please note that final action on the findings and recommendations should be completed within one year of the management decision to preclude listing in the Semiannual Report to Congress. Follow your internal procedures in forwarding documentation for final action to the Office of the Chief Financial Officer.

If you have any questions, please call me at (202) 720-6945 or have a member of your staff contact Philip T. Cole, Director, Rural Development and Natural Resources Division, at (202) 720-6805.

/S/
RICHARD D. LONG
Assistant Inspector General
for Audit

## SUMMARY:

This report contains the results of our audit of Rural Utilities Service (RUS) approval of sales of capital assets. We assessed only those sales that resulted in direct payments to private individuals. This audit originated from a congressional request that we review the sales terms for both a telephone cooperative that has outstanding loans with RUS, and for its television system subsidiary. Specifically, we were asked "Under what authority can a board member or general partner of a non-profit corporation * * * obtain personal monetary gain as a result of the sale of that corporation's assets?" We expanded our review to include both telephone and electric borrowers with asset sales allowed by RUS where board members, partners, and employees received compensation related to the sales. RUS had previously referred the three cooperatives in our review to the Office of Inspector General (OIG), Investigations, once it became aware that side payments had been made. We also assessed RUS policies and practices with regard to approval of asset sales involving these types of monetary distributions.

RUS had allowed the sale of capital assets that resulted in the distribution of cash proceeds to private individuals. RUS stated that it was unaware of the side payments when it approved the sales. We identified over $2.9 million disbursed or promised to general managers and other leaders having stewardship responsibility for the cooperatives, which were the direct result of the sale of capital assets. RUS' policy requires that sale proceeds be deposited to specific accounts for purposes approved by RUS or for the benefit of the cooperative, used for prepayment of outstanding RUS loans, or used to purchase or replace property that would be useful to the cooperative. Distribution to private individuals occurred, in part, because the agency did not have procedures to identify and control such disbursements. As a result, funds that could have been used to further RUS approved goals were diverted for personal use.

Further, the direct payments to individuals created the appearance of a conflict of interest.

In its response to the official draft report, dated May 22, 2002, RUS agreed to the report's recommendations. Their response has been attached in its entirety as exhibit B. In addition, RUS had several comments on the report's content, which we have responded to under the "AGENCY COMMENTS" and "OIG POSITION" sections of the audit report.

## BACKGROUND:

RUS, an agency within the mission area of Rural Development, makes loans to electric and telecommunication cooperatives to facilitate the delivery of these services to rural areas. In addition to the basic services supported by RUS, many cooperatives have also purchased other businesses, such as satellite television and digital broadcast systems, which become part of the capital assets of the cooperative. With few exceptions, the capital assets of the cooperatives serve as collateral for the RUS loans.

RUS has established controls to regulate the use and disposition of capital assets. Borrowers must request and receive written approval for the sale from RUS, which includes a subsequent request for release of RUS' lien on the asset. The forms requesting approval of the sale include

information about the property, its present value, and the reason for the sale.[1] The borrower certifies several conditions, to include a selling price not less than the fair market value of the property and that the sale is in the best interest of RUS and the cooperative. The Administrator or his designee then approves the sale, releasing the assets that had served as collateral for the RUS loan. RUS officials stated that requiring cooperatives to return the original sales price of the sold asset to RUS controlled accounts ensures that the RUS loan is secured.

Some RUS electric and telephone borrowers invested cooperative funds in television franchise businesses. As these businesses increased in value, a market for the franchise rights evolved and some cooperatives decided to sell all or part of the television franchise rights. Intermediaries contacted the cooperatives and offered their services in valuing the franchises, assisting consummation of the sale, and rendering specialized legal advice.

One intermediary included in its solicitation an offer to participate in "non-compete payment negotiation." According to a letter sent by the intermediary, "We level the playing field by requesting terms you may not even consider."

## OBJECTIVES:

The audit objective was to assess RUS policy and procedures for approving the sale of capital assets when direct payments are made to board members, partners, and employees.

## SCOPE AND METHODOLOGY:

We assessed RUS regulations and procedures that were in place for fiscal year 1998 through October 2001, the time of our audit. We judgmentally selected for review three RUS cooperatives that had sales of capital assets involving noncompetition and consultancy agreements. Two were electric cooperatives that were selected after they had been reviewed by OIG, Investigations, at the request of RUS. The other selection was a telephone cooperative and was reviewed in response to a congressional inquiry. We analyzed OIG investigative casefiles for the two selected sales by the electric borrowers, and RUS casefile information for all three selected sales. We also interviewed the complainants, and RUS National and field office staff. Our review was conducted in Washington, D.C.

Based on our review, the agreements were frequently "confidential" and not disclosed to the members of the cooperatives or to RUS. The scope of our review was limited because RUS did not keep records about noncompetition agreements and consultancy agreements, which resulted from the sale of capital assets. Thus, we were unable to determine the severity of the problem reported.

Except for the scope limitation cited above, the audit was conducted in accordance with generally accepted government auditing standards.

[1] REA Form 793 "Request for Release of Lien and/or Approval of Sale", dated June 1960 (Telecommunications Program)
REA Form 369 "Request for Approval to Sell Capital Assets" dated December 1972 (Electric Program)

## INADEQUATE CONTROLS OVER THE SALE OF CAPITAL ASSETS

The sale of capital assets by certain RUS borrowers resulted in cash payments to private individuals. These direct payments occurred, in part, because the agency did not have procedures to identify and control such disbursements. As a result, over $2.9 million of cash proceeds that could have been used to further RUS approved goals were diverted to individual use. We found that $2,169,320 had been paid to individuals at the time of, or close to, the sale date, while $771,518 had been promised to one of these individuals over a 2-year period. The direct payments to individuals created the appearance of a conflict of interest.

Rural Electrification Administration (REA) Bulletin 115-1, section II.B.1. (c), dated December 29, 1972, requires electric borrowers to dispose of sale proceeds in a specific manner. REA was the predecessor agency to RUS. Similarly, REA Bulletin 415-1, section IV, dated July 27, 1966, regulates the disposition of sale proceeds of capital assets of telephone borrowers. Both bulletins restrict the use of sale proceeds (less out-of-pocket expenses) to three purposes. Sale proceeds can be deposited to the construction fund account for purposes approved by RUS, used for prepayment of outstanding RUS loans, or used to purchase or replace other property that would be useful to the cooperative. [2]

Our review identified instances where private individuals entered into side agreements that resulted in direct payments to individuals. The following example illustrates how a portion of the proceeds of an asset sale went to leaders of the cooperative, instead of being deposited to specific cooperative accounts, or used to pay down the RUS loans.

> In connection with the $17 million sale of one cooperative's digital broadcast system television franchise rights, the general manager signed the statement "I hereby certify that the selling price is not less than the fair market value of the property; the sale is in the best interest of the mortgagee(s) [i.e. RUS] and this organization [i.e. the RUS borrower]; the system after the sale will constitute a satisfactory operating unit and will not jeopardize the repayment of the REA or other loans, if any; and that all necessary approvals have been or will be obtained where required by law or by the articles of incorporation or by-laws of this organization."
>
> We found that this certification created the appearance of a conflict of interest, as the general manager also signed a noncompetition and consultancy agreement to personally receive a total of $1,060,838 from the purchaser of the franchise ($289,320 at closing,

[2] The RUS Administrator, at the time, issued a waiver on May 15, 1997, that allowed cooperatives to deposit only a portion of the sale proceeds to the RUS construction account, in the amount of the original investment of the sold assets. In the two electric borrower cases reviewed, the amount deposited to the RUS construction account was only a small portion of the total sale proceeds. At one cooperative, the television franchise rights had been purchased in 1993 for $1.4 million and then sold for $17 million in 1997. Only the $1.4 million, or 8 percent, was deposited to the RUS construction account. The other electric cooperative had a similar percentage. Prior to the waiver, all sale proceeds had to be deposited to the construction fund account to be used for RUS purposes. The waiver allowed the remainder of the sale proceeds to be deposited to the cooperative's general fund. However, the waiver was never codified into the Code of Federal Regulations.

and $771,518 over the next two anniversary dates of the sale). According to the general manager, he did not provide information about this side agreement on the form requesting RUS approval because there was not a place on the form for the information. We also noted that the Letter of Intent proposing the sale to the general manager was marked "confidential" and included provisions limiting disclosure.

We concluded that the compensation was closely linked to the sale (and not to future employment), since the compensation would be paid even if the general manager died before rendering the "services" to be provided. We did not find evidence that the price received from the purchaser was not fair market value or that the sale was not in the best interest of RUS or the cooperative; these issues were outside the scope of our audit. However, we believe that the existence of an undisclosed agreement for payment of over $1 million casts doubt about the objectivity of the general manager's decision to support the sale of the asset.

In addition to payments to the general manager, the purchaser also paid the cooperative's attorney $130,000, while the cooperative's vice president for administration received $100,000 and the manager of communications and marketing received $70,000, for entering into noncompetition agreements. These confidential cash payments also create an apparent conflict of interest.

The money used to pay the general manager and other leaders of the cooperative became available through sale of the cooperative's television franchise rights, collateral for the RUS loan. Funds were not used to pay down the RUS loan[3] or to benefit the cooperative, as required by RUS policy. The cooperative could have made good use of the funds, as it charged the highest retail electric rates in the State of Alabama. Four of the counties served are considered poverty counties and much of the service area is very low income with high unemployment. It is estimated that in one county 70 percent of personal income is some type of welfare transfer payment.

Our review disclosed other situations that also resulted in direct payments that depended on the sale of assets to a third party. For example, the Term Sheet for another sale (the subject of the congressional inquiry) included cash compensation of $250,000 each for four board members and the general manager of the cooperative, and for the general manager of the cooperative's television subsidiary, for a total of $1,500,000.

In a third instance, where a direct payment was made to an individual, the cooperative stated that the payment for an $80,000 side agreement came directly from the purchaser, and thus was not part of the proceeds of the asset sale. However the "Preliminary Purchase Price Summary" showed a total adjusted purchase price of $11,340,283. The associated disbursement schedule showed (1) the amount due to the cooperative at closing, (2) a note payable to the cooperative, (3) escrow amounts, and (4) an amount labeled "Non-Competition Agreement." The total of these amounts equaled the total

[3] As of October 1997, the date of the sale, the borrower had over $14 million in RUS loans, which included an $8.8 million RUS hardship loan.

adjusted purchase price of $11,340,283. Thus, we concluded that the cash for the side agreement came from the purchase price paid for the asset.

Since many of these side agreements are kept confidential, RUS officials were unable to determine the number of asset sales involving payments to private individuals. We were also unable to determine the degree to which the proceeds of the sale of RUS collateral went to private individuals. However, RUS did provide us with records listing another 13 sales of similar television franchise rights. Many of these sales could also have had side agreements.

When RUS approval is required for the sale of capital assets, the agency receives certifications from officers of the cooperative that attest to the fair market value of the sales price, and that the sale is in the best interests of RUS and the borrower. The forms for requesting approval were last revised long before the advent of satellite television systems and similar franchises,[4] and neither addressed nor anticipated sales of capital assets involving noncompetition and consultancy agreements. RUS officials concluded that the best interests of the Government were met because the cooperatives made large profits from the sale of the franchise rights, thereby increasing the ability to pay off RUS loans. Further, RUS stated that by requiring cooperatives to return the original sales price of the sold asset to RUS controlled accounts, that their loans were secured.

To avoid the appearance of a conflict of interest, and to help ensure that the proceeds of asset sales are used in accordance with program regulations and policies, RUS should amend the forms used by RUS borrowers to request approval to sell capital assets. This should include a certification that the requesting official, and other cooperative leaders such as board members, directors, and attorneys, do not have a personal financial interest in the sale. If personal financial interests do exist, RUS should require that all side agreements and identities of interest[5] have been fully disclosed to the cooperative and to RUS. When the certifying official or other cooperative members have a personal financial interest in the outcome of the sale, RUS should extend the level of evidence and scrutiny required for approval, to include requiring independent appraisals to identify the fair market value of the capital assets being sold.

We are not recommending that RUS recover the $2.9 million at this time due to the legal and procedural difficulties arising from prior release of the collateral.

**GENERAL COMMENT:**

RUS officials stated that after they approved the sales they became aware of the side agreements and referred the issue to OIG, Investigations. However, the criminal investigations performed on the two cooperatives referred to OIG were declined for prosecution by the Assistant United

[4] REA Forms 793 and 369 were last updated in June 1960 for the Telecommunications Program, and in December 1972 for the Electric Program, respectively.

[5] An identity of interest exists between two parties, such as a RUS borrower and the purchaser of the borrower's capital assets, when a personal financial interest exists, when one party advances funds to the other, or when there come into being any side deals, agreements, contracts, or understandings thereby altering or amending the relationship between the parties involved in the transaction.

States Attorney. RUS noted that the two investigations concluded that the noncompetition agreements were legal and a common business practice. RUS officials should be aware that the need for policy change is not dependent on a prosecutive determination. The issues described in this audit report warrant corrective action by RUS, regardless of whether a criminal prosecution will result from any undisclosed side agreements. Implementation of our recommendations could add support for prosecution in the future if similar transactions occur.

## RECOMMENDATIONS:

1. Amend the RUS approval forms to include a certification that the requesting official and other cooperative leaders or members do not have a personal financial interest in the proposed sale of capital assets, which represent collateral for the RUS loans. Alternatively, if personal financial interests do exist, RUS should require a certification that all side agreements and identities of interest resulting in payments to private individuals have been disclosed to RUS and to members of the cooperative.

2. In instances where there is an identity of interest between the official certifying to conditions of the proposed asset sale or other cooperative leaders or members and the entity purchasing or acquiring the capital assets, require additional support (e.g., independent appraisals and feasibility studies) for the certifications before granting RUS approval of the sale.

## AGENCY COMMENTS

RUS agreed with the recommendations contained by the audit report. RUS has agreed to pursue regulatory changes to require that cooperatives prohibit or disclose instances where cooperative leaders or members have a personal financial interest in the sale of capital assets prior to RUS' approval of the sale. In the interim, the agency has issued a memorandum advising their staff that this information must be disclosed prior to RUS approval of capital asset sales.

## OIG POSITION

Based on the RUS response, we accept management decision for both report recommendations. To complete final action for Recommendation No. 1, RUS needs to provide the amended forms used to approve the sale of capital assets. The amended forms must include a certification that noncompetition, consultancy, or other types of agreements (where individuals gain financially from the sale of capital assets) are not part of the sale. However, if they do exist, the agreements must be disclosed. RUS must also provide documented procedures that will ensure that the new forms are consistently used for all sales of capital assets. To complete final action for Recommendation No. 2, RUS needs to provide evidence that they have established internal controls that will require additional support, analysis, and scrutiny for capital asset sales that involve noncompetition, consultancy, or other similar type agreements. Although not tied to achieving final action, RUS needs to continue to pursue regulatory changes to codify the interim corrective actions that have been initiated.

We appreciate RUS' cooperation and assistance during this audit. We commend the agency's implementation of interim corrective measures to address the reported issues while it pursues regulatory improvements. In addition to the comments on the recommendations, RUS also commented on the content of the report. We have summarized these comments and have provided our responses. The complete agency response is attached as exhibit B to the report.
RUS stated that the report recommendations agreed with the decisions and actions made by RUS after OIG, Investigations, had issued their reports on the two RUS borrowers. RUS said that they submitted workplans to the Office and Management and Budget (OMB) well before OIG began its audit of RUS procedures. In the interim, while regulatory changes are pursued by RUS, the Assistant Administrator of the Electric Program issued a memorandum on April 10, 2002, which instructs RUS' Electric Program Directors on the procedures that should be followed until the proposed rule is finalized.

RUS stated that they made "decisions" after they received the results of the two OIG investigative reports. However, RUS provided no evidence of any "actions" that were taken on the investigative results. After RUS referred the cooperatives that they knew to have noncompetition agreements to OIG, Investigations, in September 1998, the agency took no further action. Although RUS may have been in the process of codifying their policies and procedures, we found no evidence that these efforts addressed the issue of noncompetition and consultancy agreements. Our review, which began well before (in February 2001) the RUS submission of workplans to OMB (in February 2002), resulted in RUS' agreement to include the issue of noncompetition and consultancy agreements into their efforts to codify RUS policies and procedures. Our review also prompted the issuance of the April 10, 2002, memorandum that requires the disclosure of these types of agreements.

RUS stated that the OIG investigations reported no instances of wrongdoing and determined that noncompetition agreements were legal and a common business practice in the telecommunications industry. RUS suggested that the report be expanded to clearly indicate this statement. RUS stated in their May 22, 2002, response that based on the investigative conclusions, they decided that actions could not be taken on the sales that had occurred, but could change its regulations to provide tighter restrictions on such sales in the future.

However, during the audit, RUS stated that the agency took no corrective actions because OIG had concluded that noncompetition agreements were legal and a common business practice in the telecommunications industry. We note that OIG, Investigations, makes determinations on its cases based on whether sufficient evidence is available for criminal prosecution. RUS continues to confuse investigative versus audit objectives/results. As clearly stated in the report, the need for policy change is not dependent upon a prosecutive determination. Using RUS' logic, any issue or deficiency which OIG, Investigations, reports as having no wrongdoing, or that is not illegal, would require no more review or corrective action by the agency. Also, the investigative conclusion that these agreements are legal and a common business practice has been, and will continue to be, included in the "GENERAL COMMENT" section of the report.

RUS disagreed with our reported scope limitation. Our scope limitation was based on the fact that RUS did not keep records on noncompetition and consultancy agreements. RUS stated that

it would be impossible for RUS to maintain records on these documents when it did not know that such agreements existed. RUS said that they provided OIG, Investigations and Audit, with a complete list of satellite television sales that they had approved. RUS wrote that OIG auditors were free to expand the scope of their audit as they considered necessary, and, therefore, any scope limitation was self-imposed.

It is RUS' responsibility to identify and maintain records on significant issues that affect its programs, such as noncompetition and consultancy agreements. RUS did not have records of all completed, planned, or potential asset sales that involve noncompetition and consultancy agreements. This information would provide the report with perspective and would disclose whether the reported conditions were isolated instances or widespread occurrences. The potential for future occurrence of these types of agreements and payments to individuals is unknown to RUS. Without this information, the sample of agreements that we reviewed cannot be related to the total universe of noncompetition and consultancy agreements. Further, it would seem prudent that RUS would need this information before it expends resources to seek regulatory change on an issue for which the agency has no knowledge as to its potential for reoccurrence. Since these agreements are a common business practice in the industry, it would seem appropriate that RUS should be aware and knowledgeable of such a common business practice. It is RUS' responsibility, not OIG's, to identify these types of agreements. The agency has recognized this responsibility by issuing the April 10, 2002, memorandum requiring that these agreements be disclosed to the agency.

RUS stated that OIG presented no evidence to support its finding that $2.9 million paid to individuals was diverted from furthering RUS-approved goals. They based this conclusion on our statement that we did not find any evidence that the price received from the purchaser was not fair market value or that the sale was not in the best interest of RUS or the cooperative. Therefore, RUS determined that it is impossible for us to conclude that the funds were diverted from furthering RUS-approved goals. They state that these payments may well have been in excess of the fair market value of the assets sold, and in fact have been legitimate payments made under noncompetition agreements.

We did state that we did not determine whether the sales price was fair market value. However, this is not an OIG responsibility. It is the responsibility of RUS, and it is one that has not been fulfilled. RUS procedures require the agency to approve the sales of capital assets, which includes an approval of the cooperative's certification that the sales price was not less than fair market value. Our review found that RUS has approved these sales without knowing whether the sales price was fair market value. Whether or not the sales prices were fair market value, it's a fact that the $2.9 million was paid or pledged to high-ranking individuals of the cooperatives, and did not benefit the cooperative or RUS-approved goals.

Furthermore, RUS needs to recognize that the diversion of these payments to the private benefit of individuals is a direct loss of this good will from the cooperative. Some of these funds could have been disbursed to the cooperatives after RUS-approved goals had been met, and subsequently used for the needs of the cooperatives, or alternatively, distributed to cooperative

members as capital credits. However they were not and the $2.9 million went to private individuals.

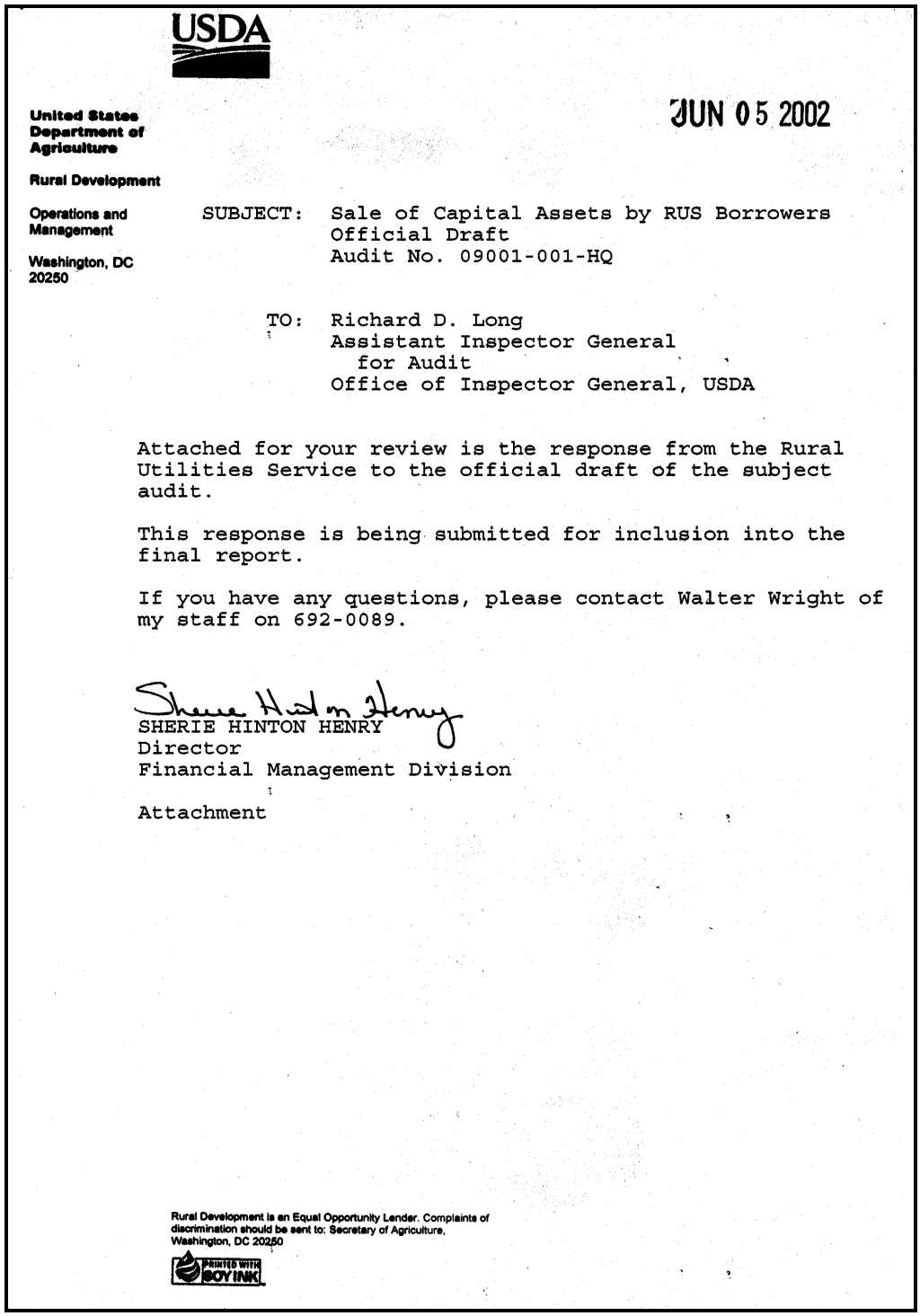
Finally, RUS said it was important to note that the noncompetition payments were made to individuals by the buyers, and that these funds were never received or disbursed by the cooperative. However, we found that one of the cooperatives we reviewed received $100,000 for a noncompetition agreement, a fact unknown to RUS. We did not take exception to that payment because it did benefit the cooperative.

## EXHIBIT A – SUMMARY OF MONETARY RESULTS

| Finding No. | Description | Amount | Reference |
|---|---|---|---|
| 1 | Sales proceeds, derived from the sale of capital assets, were diverted to private individuals and away from RUS-approved goals and cooperatives | $2,940,838 | 1 |

1 Questioned Costs and Loans, No Recovery

## EXHIBIT B – AGENCY RESPONSE



USDA

United States Department of Agriculture

Rural Development

Operations and Management

Washington, DC 20250

JUN 05 2002

SUBJECT: Sale of Capital Assets by RUS Borrowers
Official Draft
Audit No. 09001-001-HQ

TO: Richard D. Long
Assistant Inspector General
for Audit
Office of Inspector General, USDA

Attached for your review is the response from the Rural Utilities Service to the official draft of the subject audit.

This response is being submitted for inclusion into the final report.

If you have any questions, please contact Walter Wright of my staff on 692-0089.

SHERIE HINTON HENRY
Director
Financial Management Division

Attachment

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United States Department of Agriculture
Rural Development

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

May 22, 2002

SUBJECT: Sale of Capital Assets by RUS Borrowers
Official Draft
Audit No. 09001-001-HQ

TO: Richard J. Buddemeyer
Acting Director
Financial Management Division

FROM: HILDA GAY LEGG
Administrator
Rural Utilities Service

This is in response to your memorandum dated May 2, 2002, concerning the Official Draft of Audit No. 09001-001-HQ issued by the Office of Inspector General (OIG) on the sale of capital assets by Rural Utilities Service (RUS) borrowers.

RUS agrees with the recommendations made by the OIG auditors. These recommendations are consistent with the actions taken by RUS after it received the results of the OIG investigations of Baldwin County Electric Membership Corporation (Baldwin), Summerdale, Alabama, and Pioneer Electric Cooperative, Inc. (Pioneer), Greenville, Alabama. RUS is pleased that the draft OIG audit report supports the decisions made by RUS after it received the results of the OIG investigations.

The USDA OIG-Investigations issued reports on its investigations of Baldwin (dated December 13, 2000) and Pioneer (Dated April 9, 2001). In these reports OIG advised RUS that no facts were developed during its investigations to substantiate any allegations of wrongdoing. OIG Investigations also advised us that it determined, during its investigations, that Non-Competition Agreements are legal and are a common business practice in the telecommunications industry. Based upon OIG's conclusions, the RUS Electric and Telecommunications Programs determined that they could not take action on those sales that had already taken place; however, each program could change its regulations and procedures to insure tighter restrictions on such sales in the future.

The Electric Program submitted a workplan to the Office of Management and Budget (OMB) to begin the regulatory process on February 4, 2002, well before OIG began its

audit of RUS procedures. OMB has designated this action "not significant". RUS anticipates that the formal revision of its internal procedures will be completed when the proposed rule is finalized. In the interim, the Assistant Administrator, Electric Program, issued a memorandum dated April 10, 2002, which instructed the Program Directors on the procedures that should be followed until the necessary revisions have been finalized.

The Telecommunications Program is currently in the process of codifying its sale of capital assets procedures in 7 CFR Part 1744. A workplan has been submitted to OMB for inclusion in the current regulatory cycle. Until such time as the final regulation is implemented, the Telecommunications Program has also issued a memorandum adopting interim procedures to implement OIG's recommendations.

While RUS does not take issue with the recommendations made by OIG, we identified several comments in the official draft that were misleading. To eliminate any further confusion or misunderstandings that may arise, we present the following comments:

The OIG auditors stated that the scope of its audit was limited because RUS did not keep records. We disagree with this statement. Obviously, it is impossible for RUS to maintain Non-Competition agreements when it did not know that such agreements existed. However, RUS did provide both the OIG investigators and the OIG auditors with a complete list of all the satellite TV sales that were approved by RUS. Both the OIG investigators and the OIG auditors elected to investigate and audit only those borrowers that RUS discovered had Non-Competition agreements. Since RUS provided a list of all satellite TV sales that were approved, OIG auditors were free to expand the scope of their audit as they considered necessary. Therefore, any scope limitations that were imposed on the OIG investigation or the OIG audit were self-imposed and not the result of inadequate record keeping.

Sections of the official draft are worded so as to give the impression that because of the existence of Non-Competition agreements something illegal or sinister occurred. To provide the reader with a clear understanding of what occurred, RUS suggests that the report be expanded to clearly indicate that the OIG investigations found and reported that Non-Competition agreements are legal and a common business practice in the telecommunications industry.

OIG states that "the sale of capital assets by certain RUS borrowers resulted in cash payments to private individuals. These direct payments occurred, in part, because the agency did not have procedures to identify and control such disbursements. As a result, over $2.9 million of cash proceeds that could have been used to further RUS approved goals were diverted to individual use." Yet, OIG presented no evidence to support this finding. In fact, OIG states that it did **not** find evidence that the price received from the purchaser was **not** fair market value or that the sale was **not** in the best interest of RUS or the cooperative. OIG states that it limited its audit scope and did not even review these issues. Therefore, it is impossible to conclude that any of the $2.9 million paid to individuals was diverted from furthering RUS-approved goals.

Without any investigation or audit procedures performed, these payments may well have been in excess of the fair market value of the assets sold and, in fact, legitimate payments made under Non-Competition agreements, agreement that OIG, itself, concluded were legal and a common business practice in the telecommunications industry. It is also important to note that all payments made to individuals were made by the buyer, through Non-Competition agreements, as a part of the sale and the funds were never received or disbursed by the cooperative.

We appreciate the opportunity to address our concerns and would like to thank the OIG audit team for its recommendations. These recommendations will be incorporated into the revision of our regulations and internal procedures - a task that was initiated prior to the start of the OIG audit.

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