USDA
United States Department of Agriculture
Rural Utilities Service
Informational Publication 400-2

1998 Annual Report

Rural Telephone Bank

May 1999

The Honorable Dan Glickman
Secretary of Agriculture
U.S. Department of Agriculture
Washington, DC 20250

Dear Secretary Glickman:

This report covers the activities of the Rural Telephone Bank for fiscal year 1998. It is respectfully submitted, on behalf of the Bank's Board of Directors, for transmittal to the Congress pursuant to section 405(i) of the Rural Electrification Act of 1936, as amended.

Sincerely,

Wally Beyer
Governor

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Thank you for investing in the

Rural Telephone Bank.

We appreciate your past support

and look forward to serving your

financing needs in the years ahead

Wally Beyer
Governor
Rural Telephone Bank

STOCKHOLDER LETTER

Dear Stockholder:

The Rural Telephone Bank (Bank) was designed to assure rural telephone systems access to private sources of capital by establishing a supplemental credit mechanism to which borrower systems may turn for all or part of their future capital requirements. Since its inception in 1971, the Bank has approved over $3.6 billion in loans to rural telecommunications companies to help build America's telecommunications infrastructure. Today, more than 26 years later, the Bank has developed into a successful, forward-focused program with a continuing, strong demand for investment capital.

Ownership of the Bank, in addition to the U.S. Government, is shared by borrowers, former borrowers, and other related organizations authorized to invest. The Bank operates on a cooperative basis and earnings, in excess of the annual return of 2 percent required on the Government's investment, are returned to the non-Government owners as patronage refunds.

In fiscal year (FY) 1998, a total of $168.1 million in loans were approved. Bank financing represented over 30 percent of the total loans approved by RUS's telecommunications loan program. Bank loans approved in FY 1998 will provide new service to approximately 67,800 residents and businesses and improved service to nearly 359,000 residents and businesses. On average, borrowers of the RUS programs (including Bank borrowers) invest in telecommunications plant at a rate of nearly $5 to every $1 of Federal investment.

During FY 1998, the Bank continued to address with its borrowers year 2000 (Y2K) compliance issues that may affect the operations of Bank-financed rural telecommunications systems. The Bank wants to help ensure that rural America steps across this threshold of time without social disruptions. We are taking an interactive role with you to aid in ensuring a smooth transition into the year 2000. We have been involved in this issue since 1996 and will continue our involvement into the year 2000 and beyond. Automated systems supporting the Bank's operations are also in the process of being modified in order to be Y2K compliant. Full implementation is anticipated well before the end of FY 1999.

Telecommunications is crucial to rural America's economic development--rural businesses must be able to compete and rural residents need better access to the global digital economy and quality health care and education. The Bank stands ready to continue its partnership with rural America to ensure that rural telecommunications providers have affordable means to modernize their networks.

Building on that partnership, the Bank will be moving efficiently to continue its vision, structure frameworks, and set an agenda for action that moves the Bank forward to benefit rural telecommunications users and enhance the quality of life in rural America.

Sincerely,

Wally Beyer
Governor
Rural Telephone Bank

Fiscal Year 1998 Highlights

Loan Funds Advanced.

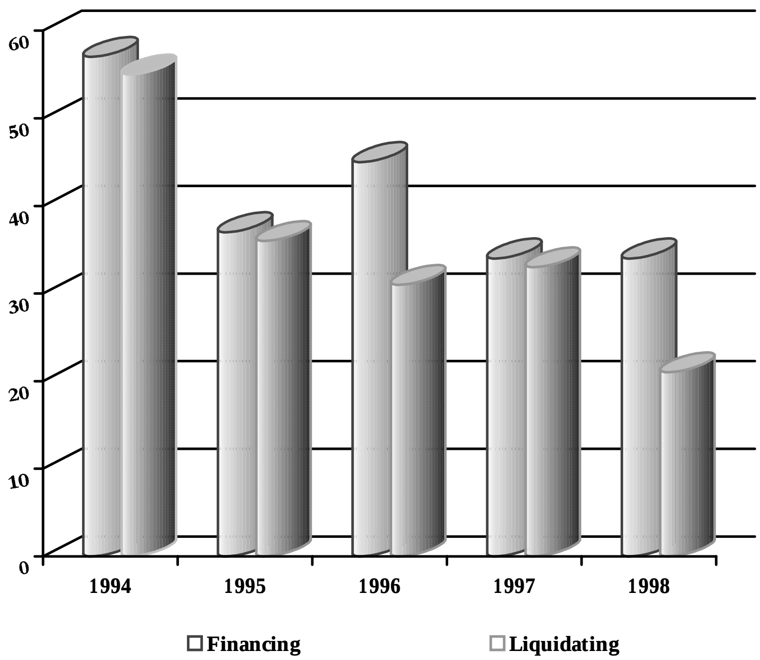
The Federal Credit Reform Act of 1990 restructured the methodology by which the Bank obtains and advances loan funds. Specifically, Credit Reform "divided" the Bank's loan program by accounting for loans made prior to fiscal year 1992 (liquidating account loans) differently from loans made during and after fiscal year 1992 (financing account loans). The Bank advanced $55.1 million in funds to borrowers in FY 1998; $20.7 million in liquidating account loans and $34.4 million in financing account loans. Over the last 5 years, Bank advances have averaged $76.4 million annually.

Interest Rates For Loan Funds Advanced.

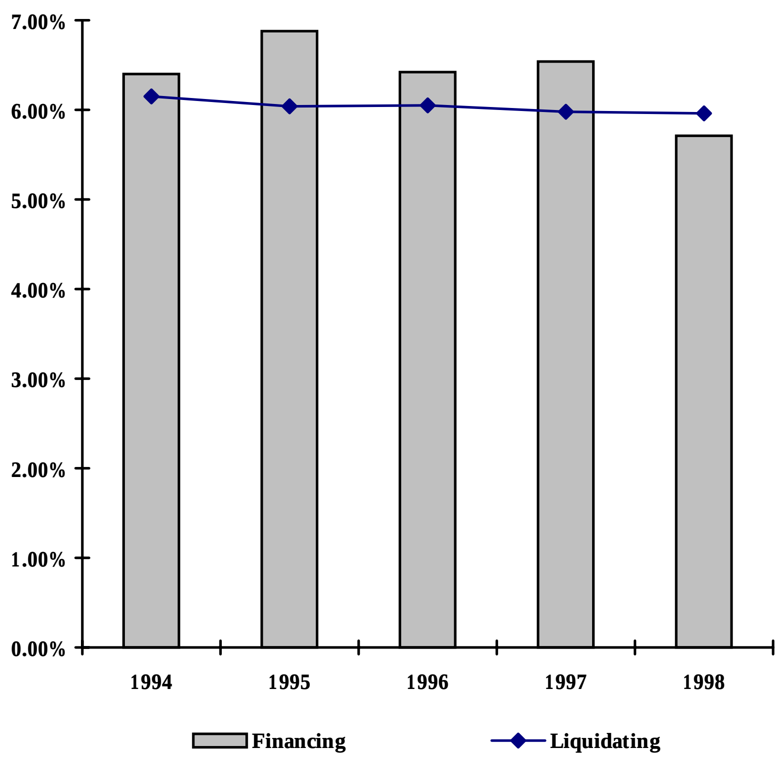
In addition, Credit Reform results in two interest rates for loan funds advanced to borrowers after fiscal year 1991. The interest rate for variable rate loans approved prior to fiscal year 1992 and advanced in fiscal year 1998 was 5.96 percent (liquidating), the rate for loans approved during fiscal years 1992 through 1998, and advanced in fiscal year 1998, was 5.71 percent (financing). Two advances on pre-1988 loans with fixed rates of 6.5 percent and 7.0 percent were also made during fiscal year 1998.

Advances of Loan Funds

(millions of dollars)



Interest Rates Charged on Loans



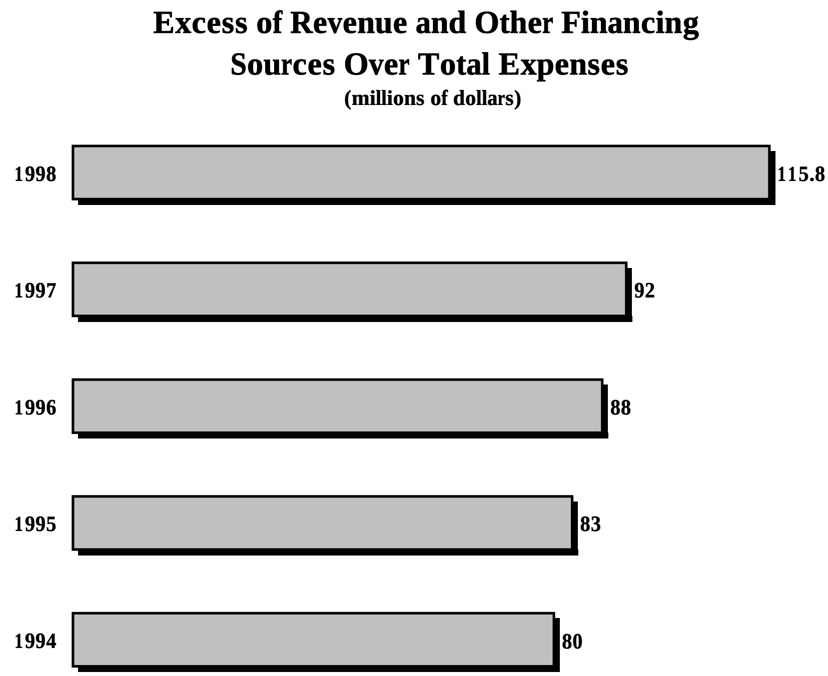
FISCAL YEAR 1998 HIGHLIGHTS

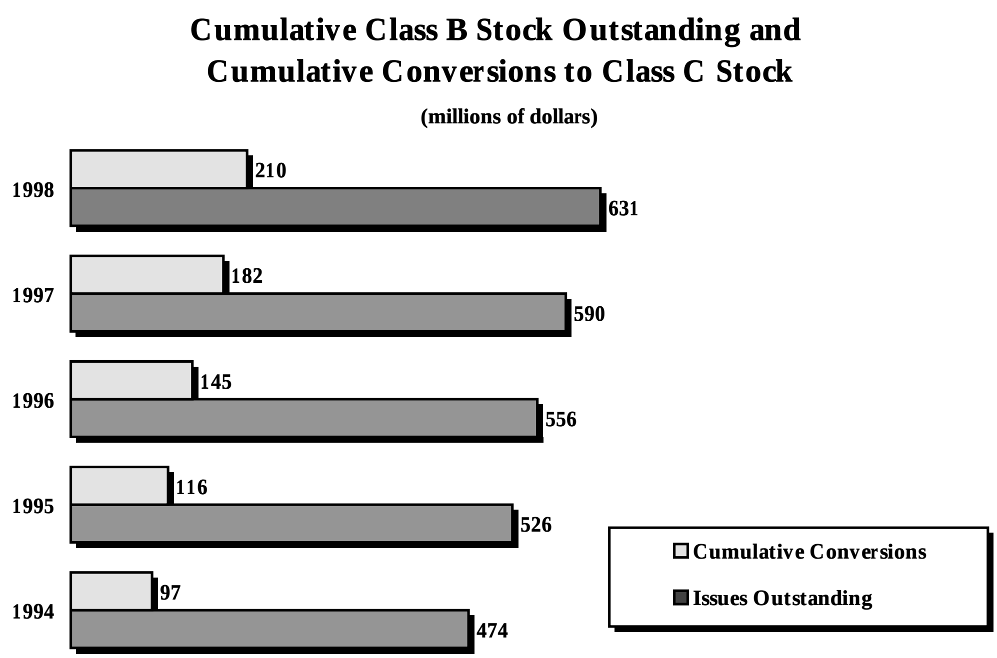
Interest Income and Patronage Capital Assignable.

Restricted capital and patronage capital at the end of fiscal year 1998 totaled $99.5 million, which includes $9.6 million earned in prior years but recognized in 1998. During 1998, interest and other income was $143.6 million. Income from appropriations was $3.5 million. Expenses amounted to $27.9 million, leaving an excess of revenues and other financing sources over total expenses of $115.8 million. A return of $11.1 million paid to the U.S. Treasury and a cash dividend of $14.4 million paid to Class C stockholders resulted in patronage capital assignable of $79.9 million.

Dividends and Patronage Refunds.

The Bank Board of Directors declared a cash dividend of 7.25 percent on Class C stock at its August 21, 1998 meeting. This represented the 26th consecutive annual dividend by the Bank. A patronage refund was also declared for fiscal year 1998.


Excess of Revenue and Other Financing
Sources Over Total Expenses
(millions of dollars)
1998
115.8
1997
92
1996
88
1995
83
1994
80


Cumulative Class B Stock Outstanding and
Cumulative Conversions to Class C Stock
(millions of dollars)
1998
210
631
1997
182
590
1996
145
556
1995
116
526
1994
97
474
Cumulative Conversions
Issues Outstanding

FISCAL YEAR 1998 HIGHLIGHTS

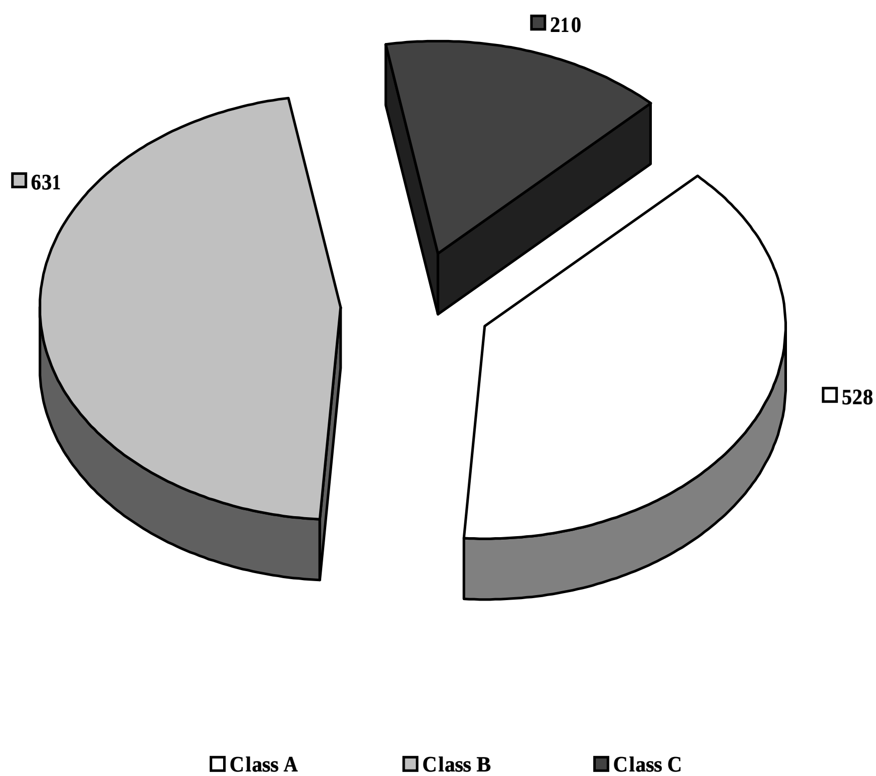
Stock Sales.

No additional Class A stock was purchased by the Government during fiscal year 1998. The cumulative total of Class A stock purchases to date is $592.1 million. In accordance with Board Resolution 98-5, $27.8 million in Class A stock was redeemed on September 30, 1998; leaving a net outstanding of $528.2 million. This was the third consecutive annual redemption of Class A stock.

Bank borrowers purchased $2.4 million in Class B stock, bringing the cumulative total purchased to $128.6 million. Total Class B stock outstanding, including patronage refunds and net of amounts converted to Class C stock, increased by $41.8 million during fiscal year 1998, to $631.4 million. Cumulative Class C stock rose to $210.5 million.

Stockholder Equity Shares Outstanding

(millions of dollars)



BOARD OF DIRECTORS

Representing the U.S. Department of Agriculture

Jill Long Thompson, Chairperson of the Board
Under Secretary, Rural Development
Washington, DC

Michael V. Dunn
Assistant Secretary
Marketing and Regulatory Programs
Washington, DC

Sharron Harris
Director
Office of Small Disadvantaged Bus. Utilization
Washington, DC

Dr. I. Miley Gonzalez
Under Secretary
Research, Education, and Economics
Washington, DC

Carl S. Whillock
Special Assistant to the President
for Agriculture and Trade
Washington, DC

Representing the Public

Jimmie Lou Fisher, Vice Chair of the Board
State Treasurer
Little Rock, AR

Robert Lee Stanton
Farmer
Rock Port, MO

BOARD OF DIRECTORS

Representing Cooperative-Type Stockholders

John A. McAllister, Treasurer of the Board
President
West Carolina Rural Telephone Cooperative, Inc.
Mt. Carmel, SC

David Crothers
Executive Vice President & General Manager
North Dakota Association of Telephone Coops.
Mandan, ND

Larry E. Sevier
Chief Executive Officer
Rural Telephone Service Co., Inc.
Lenora, KS

Representing Commercial-Type Stockholders

Curtis A. Sampson, Secretary of the Board
Chairman and Chief Executive Officer
Hector Communications Corporation
Hector, MN

John T. Dillard
President & General Manager
Monroe Telephone Company
Monroe, OR

S. Michael Jensen
Chief Executive Officer
Great Plains Communications, Inc.
Blair, NE

STAFF

Governor

Wally Beyer
Administrator, RUS

Deputy Governor
Christopher A. McLean
Deputy Administrator, RUS

Assistant Governor
Roberta D. Purcell
Assistant Administrator, RUS

Deputy Assistant Governor & Assistant Secretary
Jonathan P. Claffey
Deputy Assistant Administrator, RUS

Assistant Treasurer
Victoria Bateman
Chief Financial Officer
Rural Development, USDA

As provided by law, the Administrator of the Rural Utilities Service (RUS) serves as the Governor of the Bank. In this capacity, the Governor may exercise and perform all of the Bank's functions, powers, and duties, except for matters specifically reserved for the Board of Directors. Overall policy decisions and management vest in a 13-member board composed of 7 members appointed by the President and 6 members elected by the Bank's stockholders. The Bank's operations are conducted by the employees of RUS that have similar duties and responsibilities under RUS's rural telecommunications program. In addition, RUS and the U.S. Department of Agriculture's Office of General Counsel provide facilities and administrative support to the Bank without reimbursement.

RTB

Rural Telephone Bank
1400 Independence Avenue, SW
STOP 1510, Room 4051, South Building
Washington, DC 20250-1510
(202) 720-9540
www.usda.gov/rus/rtb/index.htm

FINANCIAL STATEMENTS

□□□□ For the year ended September 30, 1998

The financial statements should be read with the following limitations in mind: (1) they have been prepared to report the financial position and results of operations of the Bank, pursuant to the requirements of the Chief Financial Officers Act of 1990; (2) while the statements have been prepared from the books and records of the Bank in accordance with the formats prescribed by the Office of Management and Budget, 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; and (3) the statements should be read with the realization that they are for 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.

CONSOLIDATED BALANCE SHEET

For the year ended September 30, 1998
(Dollars in thousands)

ASSETS	
Assets for Use by Entity:	
Federal	
Fund Balance with Treasury (Note 2)	$ 587,259
Non-Federal	
Credit Program Receivables, Net (Note 3)	1,362,488
Total Assets	$ 1,949,747
LIABILITIES	
Liabilities Covered by Budgetary Resources:	
Federal	
Accounts Payable	$ 17,846
Debt (Note 4)	432,229
Non-Federal	
Unearned Revenue	71
Other Liabilities (Note 5)	14,362
Total Liabilities	464,508
COMMITMENTS AND CONTINGENCIES (Note 6)	
NET POSITION (Note 7)	
Unexpended Appropriations	15,898
Federal	
Equity of the U.S. Government	
Capital for Class A Stock	528,200
Non-Federal	
Investment of Others	
Capital Stock Class B	631,446
Capital Stock Class C	210,487
Restricted Capital	19,647
Patronage Capital Earned	79,881
Total Investment of Others	941,461
Cumulative Results of Operations	(320)
Total Net Position	1,485,239
Total Liabilities and Net Position	$ 1,949,747

The accompanying notes are an integral part of these statements.

STATEMENT OF NET COST

For the Year Ended September 30, 1998
(Dollars in thousands)

Costs:	
Program Costs	
Federal	$ 41,012
Non-Federal	
Loans - Subsidy Expense	(13,479)
Other Program Costs	343
Total Program Production Costs	27,876
Less Earned Revenues (Note 8)	143,639
Net Cost of Operations	$ (115,763)

STATEMENT OF CHANGES IN NET POSITION

For the Year Ended September 30, 1998
(Dollars in thousands)

Net Cost of Operations	$ 115,763
Financing Sources (other than exchange revenues):	
Appropriations Used	3,461
Transfers-out	(39,663)
Changes in:	
Capital Stock - Redemption of Class A Stock	(27,800)
Investment of Others	2,415
Net Results of Operations	54,176
Prior Period Adjustments (Note 9)	9,647
Net Change in Cumulative Results of Operations	63,823
Increase (Decrease) in Unexpended Appropriations	3,241
Change in Net Position	67,064
Net Position-Beginning of Period	1,418,175
Net Position-End of Period	$ 1,485,239

The accompanying notes are an integral part of these statements.

STATEMENT OF BUDGETARY RESOURCES
For the Year Ended September 30, 1998
(Dollars in thousands)

Budgetary Resources: (Note 10)	
Budget Authority	$ 132,326
Unobligated balances – beginning of period	286,925
Spending Authority from offsetting collections	258,055
Adjustments	(72,191)
Total budgetary resources	605,115
Status of Budgetary Resources:	
Obligations incurred	203,839
Unobligated balances-available	146
Unobligated balances-not available	401,130
Total, status of budgetary resources	605,115
Outlays:	
Obligations incurred	203,839
Less: actual spending authority from offsetting collections and actual adjustments	(293,881)
Obligated balance, net - beginning of period	882,109
Obligated balance transferred, net	0
Less: obligated balance, net - end of period	(961,143)
Total outlays	$ 169,076)

The accompanying notes are an integral part of these statements.

STATEMENT OF FINANCING
For the Year Ended September 30, 1998
(Dollars in thousands)

Resources Used to Finance Operations		
Budgetary		
Budgetary Resources Obligated for Items to be Received or Provided to Others		$ 203,839
Less: Offsetting Collections, Recoveries of Prior-year Authority, and Changes in Unfilled Customer Orders		(293,881)
Net Budgetary Resources Used to Finance Operations		(90,042)
Non-budgetary		
Property Given to Others Without Reimbursement		(14,261)
Net Non-budgetary Resources Used to Finance Operations		(14,261)
Total Resources Used to Finance Operations		(104,303)
Resources Used to Fund Items Not Part of the Net Cost of Operations		
Increase or (Decrease) in Budgetary Resources Obligated to Order Goods or Services Not Yet Received or Benefits Not Yet Provided		115,942
Budgetary Offsetting Collections Not Increasing Earned Revenue or Decreasing Expense		(72,346)
Adjustments Made to Compute Net Budgetary Resources Not Affecting Net Cost of Operations		(35,686)
Other Resources Used to Fund Items Not Part of the Net Cost of Operations (Note 11)		5,564
Total Resources Used to Fund Items Not Part of the Net Cost of Operations		13,474
Resources Used to Finance the Net Cost of Operations		(117,777)
Components of Net Cost of Operations Not Requiring or Generating Resources During the Reporting Period		
Expenses or Earned Revenue Related to the Disposition of Assets or Liabilities, or Allocation of Their Cost over Time	343	
Expenses Which Will Be Financed with Budgetary Resources Recognized in Future Periods		320
Other Net Cost Components Not Requiring or Generating Resources During the Reporting Period (Note 11)		1,351
Total Components of Net Cost of Operations Not Requiring or Generating Resources During the Reporting Period		2,014
NET COST OF OPERATIONS		$ 115,763)

The accompanying notes are an integral part of these statements.

NOTE 1. SIGNIFICANT ACCOUNTING POLICIES:

A. Background, mission and concentration of credit risk: The Rural Telephone Bank (RTB), established in May 1971, provides a supplemental source of financing under the Rural Utilities Service's telephone loan program. The Rural Utilities Service (RUS) is a credit agency within the U.S. Department of Agriculture (USDA) which assists rural electric and telephone organizations in obtaining the financing required to provide electric and telephone service in rural areas. RTB lends principally to rural telephone organizations.

RTB is a government corporation which functions as an agency of the U.S. Department of Agriculture, subject to the supervision and direction of the Secretary of Agriculture. As provided by law, the Administrator of RUS serves as the Governor of RTB. In this capacity, the Governor may exercise and perform all of RTB's functions, powers, and duties, except for matters specifically reserved for its Board of Directors. As discussed below, upon retirement of the Class A stock held by the U.S. Government, the RTB would no longer operate as an integral agency of the Government.

Adverse changes in the telephone industries could have a direct and material impact on the financial capacity of RTB borrowers to provide for the repayment of loans.

B. Basis of accounting: Aided by studies and recommendations from the Financial Accounting Standards Advisory Board (FASAB), the Director of OMB and the Comptroller General published specific standards which constitute generally accepted accounting principles for the Federal Government and its component entities. This comprehensive set of accounting principals and standards must be followed by Federal entities. For those transactions deemed not addressed by FASAB pronouncements, accounting principles and standards published by authoritative standard-setting bodies and other authoritative sources shall be considered, depending upon their relevance in a particular set of circumstances.

Post-Credit Reform nonfederal transactions are recorded on a cash accounting basis, except for the accrual of interest related to borrowers loans; Federal and Pre-Credit Reform 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.

C. The Federal Credit Reform Act of 1990: The Federal Credit Reform Act of 1990 (Credit Reform) and OMB established procedures for federal agencies and departments to measure and record, for budgetary and financial accounting purposes, the costs of federal credit programs.

For loans authorized after September 30, 1991, Credit Reform required appropriations be provided to agencies to cover the costs of loan programs. These costs are classified as 1) interest costs - for loans issued at interest rates below the average U.S. Treasury borrowing rates, 2) default costs - for unrecoverable principal balances, and 3) administrative costs - for salaries and overhead. Since the interest costs and the default costs, known as subsidy costs, will be incurred gradually over the life of the loans, these appropriations represent the net present value of these costs.

These appropriations are expensed as loan funds are issued with Treasury borrowings providing the remaining funds necessary for loan advances. The appropriations are recorded in the allowance for subsidy account and represent the net present value of the subsidy costs for outstanding loans. Re-estimates are performed annually to reevaluate the reasonableness of the assumptions used in determining the net present value of these costs, with additional appropriations being provided as necessary. Loans receivable authorized after September 30, 1991 are stated net of the allowance for subsidy costs.

D. Credit Program Receivables, Net: Loans are accounted for as receivables after funds are disbursed. Loans receivable are carried at the principal amount outstanding, net of an allowance for estimated uncollectible amounts for prefiscal year 1992 loans. For direct loans obligated on or after October 1, 1991, RTB recognizes these assets at the present value of their estimated net cash inflows. The difference between the outstanding principal of the loans and the present value of their net cash inflows is recognized as a subsidy cost allowance **(Note 3)**. All loans receivable are due from non-federal borrowers and accrue interest daily based on the contractual interest rate.

RTB's allowance is estimated based on delinquency rates, current economic conditions, borrowers' credit histories, borrowers' outstanding balances, and an analysis of each borrower's financial condition.

The projected cost of direct loan defaults (for loans obligated prior to October 1, 1991) will not necessarily reflect USDA RTB's future appropriation requests. To the extent that fund revenues are not sufficient to fund future costs, financing will have to be obtained from future appropriations, or other congressionally approved sources.

E. Fund balances with U.S. Treasury: It is the policy of RTB not to maintain cash in commercial bank accounts. Cash receipts and disbursements are processed by the U.S. Treasury. Funds with the U.S. Treasury are appropriated and revolving funds which are available to pay current liabilities and finance authorized loan commitments.

RTB earns interest on all cash balances maintained at U.S. Treasury in accordance with the 1973 note executed by RTB and U.S. Treasury, Section 505 (c) of the Federal Credit Reform Act of 1990 and recent Appropriations Bills (Public Laws 104-180 and 105-86).

F. Federal liabilities: As required under Credit Reform, an agreement (note) was executed with the U.S. Treasury which provides funds for loans approved after September 30, 1991. The interest rate charged to RTB is the average annual U.S. Treasury rate, as provided by OMB.

G. Stock conversion: In accordance with its authorizing legislation and amendments, RTB will be converted to independent status at such time when 51 percent of the Class A stock issued to the U.S. Government (and outstanding at any time since September 30, 1985) has been fully redeemed and retired. When such conversion occurs, RTB will no longer be an agency of the USDA and the President will cease to appoint Board members. However, after the conversion, Congress may still continue its oversight responsibilities for RTB's operations.

H. Operations: The Rural Electrification Act of 1936, as amended, and RTB's enabling legislation, authorize RTB to partially or jointly use the facilities and services of employees of RUS, or of any other agency of the USDA, without cost. Under Credit Reform, $3 million of appropriated funds provided to RTB to cover administrative costs was transferred to RUS. This amount represents the additional cost to RUS for managing RTB. In this regard, RTB's operations are conducted by RUS administrative and program employees who have similar responsibilities under RUS's rural telephone loan program. The prorated Pension, FECA, and Unfunded leave costs, of $448,988, $9,019, and ($21,218) respectively, which are associated with the RTB program, and included in the operating costs of RUS/RD, are not included in the reported cost of the RTB operations.

NOTE 2. FUND BALANCES WITH TREASURY:

Amounts are presented in thousands of dollars.

Assets for use by Entity:	September 30, 1998
Revolving Funds	$ 571,361
Appropriated Funds	15,898
Total	$ 587,259

NOTE 3. CREDIT PROGRAM RECEIVABLES, NET

Amounts are presented in thousands of dollars.

Accounting Policy - Present Value (PV) Disclosure:

Direct loan obligations made prior to FY 1992 are reported on a net realizable value. Direct loan obligations made after FY 1991 are governed by the Federal Credit Reform Act. The Act provides that 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 be recognized as a cost in the year the loan is made. The net present value of loans receivable at any point in time is the amount of the gross loan receivable less the present value of the subsidy at that time.

Loans Subject to Credit Reform:

Summary Schedule:

	September 30, 1998
Loans Receivable, Gross	$ 1,368,185
Interest Receivable, Gross	3,395
Less: Related Allowance	(9,092)
Program Receivable Net	$ 1,362,488

This summary schedule is calculated from the detail amounts shown in the following sections.

Direct Loans Obligated Prior to FY 1992:

	September 30, 1998
Loans Receivable, Gross	$1,171,290
Interest Receivable, Gross	3,311
Less: Allowance for Credit Program Receivables (RV)	(8,102)
Credit Program Receivables (NRV)	$ 1,166,499

Direct Loans Obligated After FY 1991:

	September 30, 1998
Loans Receivable, Gross	$ 196,895
Interest Receivable, Gross	84
Less: Allowance for Subsidy Cost (PV)	(990)
Credit Program Receivables (NPV)	$ 195,989

Subsidy Expense for Post-1991 Loans and Credit Receivables:

	September 30, 1998
Current Year's Direct Loans	
Interest Differential	$ 455
Defaults	7
Total Current Year's Direct Loans Subsidy Expense	462
Fiscal Year Direct Loan Reestimates	(13,964)
Total Direct Loan Subsidy Expenses	$ (13,502)

The percentage rate used to breakout the four components of subsidy is based on the rate in effect during FY 1998. Appropriated funds, totaling $3 million, provided to RTB to cover administrative costs were transferred to RUS.

NOTE 4: DEBT

Amounts are presented in thousands of dollars.

Federal Debt	September 30, 1998
Interest Bearing: Debt to the Treasury	
Beginning Balance	$ 477,406
Net Borrowing	(45,177)
Ending Balance	$ 432,229

Legislation limits outstanding borrowings from the U.S. Treasury to an amount which shall not exceed twenty times RTB's equity. As of September 30, 1998, RTB's maximum borrowing authority approximated $29 billion. All Federal debt is covered by budgetary resources

NOTE 5: OTHER LIABILITIES

Dividends declared and unpaid on Class C stock to non-federal recipients, approximated $14.4 million, and are payable on December 15, 1998.

This liability is covered by budgetary resources.

NOTE 6: COMMITMENTS AND CONTINGENCIES

Financial Instruments with Off-Balance Sheet Risk

The Rural Telephone Bank has in the course of its loan making activities, unliquidated loan obligations which, in the absence of contractual violations or cancellations, will require disbursements. Off-balance sheet risks as of September 30, 1998, which is comprised solely of unliquidated loan obligations total approximately $946.9 million.

As of September 30, 1998, there were no obligations due to canceled appropriations for which there is a contractual commitment for payment.

NOTE 7: NET POSITION

Amounts are presented in thousands of dollars.

Unexpended Appropriations	September 30, 1998
Unobligated-Available	$ 5,422
Undelivered Orders	10,476
Total Unexpended Appropriations	$ 15,898

RTB does not have any future financing sources.

Rural Telephone Bank (RTB) Capital Stock:

A summary of the RTB capital stock structure as of September 30, 1998, follows:

	September 30, 1998
CAPITAL STOCK CLASS A ($1 par value)	
Shares authorized	600,000
Shares issued and outstanding	528,200
Cash dividends	$ 11,120
CAPITAL STOCK CLASS B ($1 par value)	
Shares authorized	Unlimited
Shares issued and outstanding	631,446
Stock dividends	67,775
CAPITAL STOCK CLASS C ($1,000 par value)	
Shares authorized	Unlimited
Shares issued and outstanding	210,487
Cash dividends (paid or accrued)	$ 14,362

Although USDA Rural Development owns all Class A stock on behalf of the United States Government, the cash dividends are paid to the U.S. Treasury. On September 30, 1998, in accordance with Section 406 (c) of the RE Act as amended, the third redemption of Class A stock occurred. In accordance with Bank Board resolution 98-5, $27.8 million was redeemed.

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. RTB may not pay cash dividends on Class B stock. Rather, holders of Class B stock are entitled to patronage refunds (paid in the form of Class B stock dividends) equal to the amount of patronage capital in excess of $10 million. Patronage refunds are allocated based on the ratio of interest revenue to RTB from each holder to RTB's total interest revenue from all Class B stockholders. Subscriptions receivable relating to unadvanced loans approximated $44 million at September 30, 1998, and are not reflected in the accompanying principal financial statements. Balances include approximately $67.1 thousand of B stock allocated but not distributed.

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, upon retiring all debt with RTB, may exchange Class B stock for Class C stock. Otherwise, the borrower retains possession of the stock. Class B stock can be redeemed only after all shares of Class A stock, a nonvoting class of stock owned by the U.S. Government, have been redeemed and retired.

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. RTB may pay cash dividends on Class C stock.

Restricted Capital:

The Omnibus Budget Reconciliation Act of 1987 required the RTB to establish a contingency reserve for interest rate fluctuations. As a result, the RTB Board of Directors amended the Bylaws of RTB regarding the allocation of patronage capital and established a reserve of $10 million. Any amounts in the reserve for interest rate fluctuations, classified as restricted capital on the Consolidated Statement of Financial Position, in excess of $10 million will be allocated as Class B stock dividends to those borrowers holding Class B stock during the fiscal year the amounts were earned. At September 30, 1998, restricted capital was approximately $19.6 million. This includes $10 million of restricted capital from fiscal year 1997, in addition to approximately $9.6 million to be distributed as a result of a prior period adjustment (to fiscal year 1997).

Patronage Capital Earned:

Patronage capital earned consists of all revenues of the RTB for any fiscal year in excess of the amount thereof necessary to:

- Pay expenses of the RTB, including without limitation, payments in lieu of property taxes.
- Pay interest on telephone debentures accruing during the fiscal year.
- Provide reasonable allowances for depreciation, obsolescence, and losses on loans and interest receivable.
- Pay to the holders of Class A stock an amount equal to 2% per annum of the capital furnished to the RTB for such stock.
- Pay to the holders of Class C stock dividends at the rate determined by the Board, provided the following criteria is met:

  (a) No dividends shall be declared on Class C stock until arrearages, if any, on payments to holders of the cumulative Class A stock have been paid.

  (b) Until all Class A stock has been retired, the Board shall not declare any dividends on Class C stock at an annual rate in excess of the then current average rate payable on the RTB's telephone debentures.

Unexpended Appropriations:

Unexpended Appropriations include the undelivered orders and unobligated balances of 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.

Capital Stock Class A:

Public Laws 92-12 and 97-98 authorized Congress, in fiscal years 1971 through 1991, to appropriate no more than $30 million per year for the purchase of RTB Class A stock. Class A stock has a guaranteed annual dividend of 2 percent of the total funds received. The law provides that Congress annually appropriate funds until such purchases approximate $600 million. As of September 30, 1998, RTB Class A stock appropriations amounted to approximately $592.1 million, the total funding USDA Rural Development will receive from Congress. Beginning in 1996, RTB was required to repurchase this stock; however, in accordance with Public Law 105-86, Section 718, the maximum Class A stock that may be retired is 5 percent. According to enabling legislation and amendments, the Bank will be converted to independent status when 51 percent of the Class A stock issued to the United States has been fully redeemed and retired. On September 30, 1998, in accordance with Bank Board resolution 98-5, the third redemption ($27.8 million) of Class A stock occurred, leaving a balance of $528.2 million outstanding.

NOTE 8: EARNED REVENUES (Budget Function Code 452)

Amounts are presented in thousands of dollars.

	September 30, 1998
Federal:	
Interest Revenue-Subsidy	$ (1,351)
Interest Revenue from Treasury	46,957
Total Federal	45,606
Non-Federal:	
Interest and Penalties Revenue	98,033
Total Non-Federal	98,033
Total Earned Revenues	$ 143,639

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 with 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 1C**, and for all of the components of subsidy expense and their respective dollar amounts by entity, refer to **Note 3**.

Exchange Transactions With Non-Federal Sources

Rural Telephone Bank loans have a statutory rate that is established on an annual basis depending on the Bank's cost of raising capital.

Exchange Transactions With Federal Sources

As the discussion in **Note 1A** attests, the history of RTB is one of financial and technical assistance to rural America. RTB serves as a temporary source of supervised credit until borrowers are able to qualify for private sector resources. Although a lender of last resort, RTB is able to recoup all of the costs associated with its loan making. The main reason is the RTB establishes its cost of money on an annual basis in a manner which enables it to recover all costs.

NOTE 9: DISCLOSURES RELATED TO THE STATEMENT OF CHANGES IN NET POSITION

Prior Period Adjustments:

As the result of a recent review of the fiscal year 1997 Agriculture Appropriation Act, P.L. 104-180, 110 Stat 1598-1599, and consultation with the Office of General Counsel, it has been determined the Bank is entitled to earn interest on all cash balances maintained at Treasury. Therefore, the income of the Bank was understated for fiscal year 1997.

The funds related to the adjustment, for interest earned on liquidating account balances were credited to the Bank by the U.S. Treasury, as of October 1, 1997. The funds are being treated as an adjustment to fiscal year 1997 income.

NOTE 10: DISCLOSURES RELATED TO THE STATEMENT OF BUDGETARY RESOURCES

A. The net amount of budgetary resources obligated for undelivered orders as of September 30, 1998, is approximately $946.9 million.

B. The amount of borrowing authority available as of September 30, 1998, is approximately $775.2 million.

C. Requirements for repayments of borrowings: Borrowings are repaid on Form SF 1151, Nonexpenditure Transfers, as maturity dates become due. For liquidating accounts, maturity dates are fifty years from the close of the fiscal year the funds were advanced by Treasury, to the Bank. 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.

Terms of borrowing authority used: In general, borrowings are for periods of up to fifty years depending upon the 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 at the end of the year of loan disbursement. Since individual loans are typically disbursed over several years, several interest rates may be applicable to an individual loan. A single weighted average interest rate which is adjusted each year, until all the disbursements for the cohort have been made, is maintained.

Prepayments can be made on Treasury borrowings in the liquidating and financing accounts without penalty.

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.

- *Adjustments during the fiscal year (in thousands of dollars) to budgetary resources available at the beginning of the year are as follows:*

Actual Recoveries of Prior Year Obligations	$ 35,825
Cancellations of Expired Accounts	(8)
Redemption of Debt	(77,538)
Other Authority Withdrawn	(30,470)
Total Adjustments	$ (72,191)

Actual recoveries of prior year obligations represent cancellations or downward adjustments of obligations incurred in prior fiscal years that did not result in an outlay. For expired accounts, these recoveries are available for upward adjustments of valid obligations incurred during the unexpired period but not recorded.

Cancellations of expired accounts represent the amount of appropriation authority which is cancelled five years after the expiration of an annual or a multi-year appropriation.

Redemption of debt represents the amount of principal repayments paid to the Treasury on outstanding borrowings. It does not include interest payments, which are shown as an obligation and an outlay.

Other authority withdrawn represents the withdrawal of unobligated balances of indefinite budget authority realized in no-year or multiple year accounts through downward adjustments of prior year obligations.

- *Existence, purpose, and availability of permanent indefinite appropriations:* Permanent indefinite appropriations are mainly applicable to liquidating accounts which have the ability to apportion them 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 expire 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.

- *Legal arrangements affecting the use of unobligated balances of budget authority:* The availability/use of budgetary resources (i.e., unobligated balances) for obligation and expenditure are limited by purpose, amount, and time.

  (a) **Purpose** - Funds may be obligated and expended only for the purposes authorized in appropriations acts or other laws.

  (b) **Amount** - Obligations and expenditures may not exceed the amounts established in 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).

  (c) **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.

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

Contributed capital received during the report period $20 thousand.

NOTE 11: DISCLOSURES RELATED TO THE STATEMENT OF FINANCING

Amounts are presented in thousands of dollars.

Other resources used to fund items not part of the net cost of operations

Prior period adjustments, as discussed in Note 9	$ (9,647)
Refunds of borrower overpayments	849
Class C stock dividends payable	14,362
	$ 5,564

Other net cost components not requiring or generating resources during the reporting period

Interest revenue on subsidy reestimates	$ 3,562
Amortization of subsidy expenses	(2,211)
	$ 1,351