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Policy on Audits of RUS Borrowers

RUS Bulletin 1773-1

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UNITED STATES DEPARTMENT OF AGRICULTURE
Rural Utilities Service

BULLETIN 1773-1

SUBJECT: Policy on Audits of RUS Borrowers

TO: RUS Electric and Telecommunications Borrowers
Certified Public Accountants

EFFECTIVE DATE: July 5, 2001

OFFICE OF PRIMARY INTEREST: Technical Accounting and Auditing Staff, Program Accounting and Services Division

AVAILABILITY: This is a new bulletin and is available on the RUS web site at http:///www.usda.gov/rus/ruswide.htm

PURPOSE: This bulletin sets forth, in a more user-friendly format, the codified policies and procedures found in Title 7 CFR Part 1773, RUS Policy on Audit of RUS Borrowers. This bulletin also includes sample reports and schedules previously codified in Appendices A through D of Part 1773, but now will be available only in this bulletin.

July 19, 2001

Blaine D. Stockton
Acting Administrator

Date

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ACCOUNTING

Policy on Audits

AUDITS

Every effort has been made to ensure the accuracy of this document, however, in case of discrepancies, the printed version available from the Government Printing Office, is the authoritative source.

Subpart A - General Provisions

§ 1773.1 General.

(a) This part implements those standard provisions of the security instrument utilized by the Rural Utilities Service (RUS) for both electric and telecommunications borrowers and by the Rural Telephone Bank (RTB) for its telecommunications borrowers. The provisions require borrowers to prepare and furnish to RUS, at least once during each 12-month period, a full and complete report of its financial condition, operations, and cash flows, in form and substance satisfactory to RUS, audited and certified by an independent certified public accountant (CPA), satisfactory to RUS, and accompanied by a report of such audit, in form and substance satisfactory to RUS.

(b) This part 1773 applies to both RUS and RTB borrowers. For the purposes of RTB borrowers, as used in this part 1773, *RUS* means *RTB* and *Administrator* means *Governor* unless the text indicates otherwise.

(c) This part complies with the 1994 revision of *Government Auditing Standards*, issued by the Comptroller General of the United States, United States General Accounting Office, including amendments dated May 13, 1999, and July 30, 1999.

(d) An auditor's report, report on compliance and on internal control over financial reporting, and management letter are required to meet the reporting provisions of the RUS security instrument.

(1) The auditor's report must state that the audit was conducted in accordance with generally accepted government auditing standards (GAGAS).

(2) The management letter must state that the audit was conducted in accordance with this part.

(3) A report of the audit, in form and substance satisfactory to RUS, cannot be issued unless and until an audit has been performed in accordance with GAGAS and this part.

(4) A borrower is in violation of provisions of its security instrument with RUS if the borrower fails to provide an audit performed in compliance with GAGAS and this part. RUS security instruments normally provide for notice and an opportunity to cure such violations before RUS can exercise certain remedies.

(5) A report prepared in connection with a review or compilation of financial statements, as defined in Statement of Standards for Accounting and Review Services No. 1, Compilation and Review of Financial Statements, does not satisfy the requirements of the RUS security instrument.

(6) A report, as described in Statement on Auditing Standards (SAS) No. 62, entitled "Special Reports", or in SAS No. 75, entitled "Engagements to Apply Agreed-

upon Procedures to Specified Elements, Accounts, or Items of a Financial Statement", does not satisfy the RUS loan security instrument requirements.

(7) An annual report containing audited financial statements does not satisfy the RUS security instrument requirements.

(e) This part further implements those provisions of the standard RUS security instrument by setting forth the criteria for CPAs to be deemed satisfactory to RUS and the audit procedures and documentation standards that must be performed before a report of the audit satisfactory to RUS can be prepared and issued.

§ 1773.2 Definitions.

As used in this part:

AA-PARA means Assistant Administrator, Program Accounting and Regulatory Analysis.

Administrator means the Administrator of RUS and, as provided in § 1773.1 (b), *Governor*.

AICPA means the American Institute of Certified Public Accountants.

Audit means an examination of financial statements by an independent CPA for the purpose of expressing an opinion on the fairness with which those statements present financial position, results of operations, and changes in cash flows in conformity with generally accepted accounting principles (GAAP) and for determining whether the borrower has complied with applicable laws, regulations, and contracts for those transactions and events reflected in the financial statements.

Borrower means an entity that has an outstanding RUS, RTB, or FFB loan or loan guarantee, or that has received a grant for electric, telecommunications, distance learning, or telemedicine purposes under the act.

CPA means certified public accountant. The terms *CPA* and *CPA firm* are used interchangeably.

FFB means the Federal Financing Bank, an instrumentality and wholly owned corporation of the United States.

Fraud has the same meaning prescribed in SAS No. 82, entitled "Consideration of Fraud in Financial Statements".

GAAP means generally accepted accounting principles.

GAGAS means generally accepted government auditing standards as set forth in *Government Auditing Standards*, Standards for Audit of Governmental Organizations, Programs, Activities, and Functions, issued by the Comptroller General of the United States.

GAO means the General Accounting Office.

Governor means the Governor of the RTB.

Illegal act has the meaning prescribed in SAS No. 54, entitled "Illegal Acts by Clients".

OIG means the Office of Inspector General, United States Department of Agriculture.

OMB means the Office of Management and Budget.

PASD means the Program Accounting Services Division of RUS.

Regulatory asset means an asset resulting from an action of a regulator as prescribed in Statement of Financial Accounting Standards (SFAS) No. 71, entitled "Accounting for the Effects of Certain Types of Regulation".

Regulatory liability means a liability imposed on a regulated enterprise by an action of a regulator as prescribed in SFAS No. 71, entitled "Accounting for the Effects of Certain Types of Regulation".

Related party has the meaning prescribed in SFAS No. 57, entitled "Related Party Disclosures".

Related party transaction has the meaning prescribed in SFAS No. 57, entitled "Related Party Disclosures".

Reportable condition has the meaning prescribed in SAS No. 60, entitled "Communication of Internal Control Structure Related Matters Noted in an Audit".

RTB means the Rural Telephone Bank.

RUS means the Rural Utilities Service, an agency of the United States Department of Agriculture established pursuant to Section 232 of the Federal Crop Insurance Reform and Department of Agriculture Reorganization Act of 1994 (Pub. L. 103-354, 108 Stat. 3178), successor to REA with respect to administering certain electric and telecommunications programs. See 7 CFR 1700.1.

RUS Bulletin 1773-1**, Policy on Audits of RUS Borrowers**, is a publication prepared by RUS that contains the RUS regulation 7 CFR part 1773 and exhibits of sample audit reports, financial statements, and a management letter used in preparing audits of RUS borrowers. This bulletin is available from USDA, Rural Utilities Service, Program Development and Regulatory Analysis, 1400 Independence Ave., SW, Stop 1522, Washington, DC 20250, or available on the internet at http://www.usda.gov/rus.

SAS means Statement on Auditing Standards as prescribed by the AICPA.

SEC Practice Section means the Securities and Exchange Commission Practice Section of the AICPA.

SFAS means Statements of Financial Accounting Standards as prescribed by the Financial Accounting Standards Board.

State means any state or territory of the United States, or the District of Columbia.

Uniform System of Accounts means, for telecommunications borrowers, the Uniform System of Accounts for Telecommunications Companies, prescribed by the Federal Communications Commission and set forth at 47 CFR Part 32, as supplemented by RUS pursuant to 7 CFR Part 1770, Accounting Requirements for RUS Telecommunications Borrowers, subpart B, Uniform System of Accounts, and, for electric borrowers, as contained in 7 CFR Part 1767, Accounting Requirements for RUS Electric Borrowers, subpart B, Uniform System of Accounts.

Subpart B - RUS Audit Requirements

§ 1773.3 Annual audit.

(a) Each borrower must have its financial statements audited annually by a CPA selected by the borrower and approved by RUS as set forth in § 1773.4.

(b) Each borrower must establish an annual as of audit date within twelve months of the date of receipt of the first advance of funds from grants and insured and guaranteed loans approved by RUS and RTB and must prepare financial statements as of the date established.

(c) Until all loans made or guaranteed by RUS have been repaid, the borrower must furnish three copies of the auditor's report, report on compliance and on internal control over financial reporting, and management letter to RUS within 120 days of the as of audit date.

(d) A borrower that qualifies as a unit of state or local government or Indian tribe as such terms are defined in the Single Audit Act of 1984 (31 U.S.C. 7501 et seq.), the Single Audit Act Amendments of 1996 (31 U.S.C. 7505 et seq.) and OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations (copy available from the Executive Office of the President, Publication Services, 725 17th St., NW, Suite 2200 Washington, DC 20502; 202-395-7332), must comply with this part as follows:

(1) A borrower that expends $300,000 or more in a year in Federal awards, must have an audit performed and submit an auditor's report meeting the requirements of the Single Audit Act of 1984 and the Single Audit Act Amendments of 1996.

(2) A borrower that expends less than $300,000 in Federal awards during the year must have an audit performed in accordance with the requirements of this part.

(3) A borrower must notify RUS, in writing, within 30 days of the as of audit date, of the total Federal awards expended during the year and must state whether it will have an audit performed in accordance with the Single Audit Act of 1984 and the Single Audit Act Amendments of 1996, or this part.

(i) A borrower that elects to comply with this part must select a CPA that meets the qualifications set forth in § 1773.5.

(ii) If an audit is performed in accordance with the Single Audit Act of 1984 and the Single Audit Act Amendments of 1996, an auditor's report that meets the requirements of the Single Audit Act of 1984 and the Single Audit Act Amendments of 1996 will be sufficient to satisfy that borrower's obligations under this part.

(e) OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, does not apply to audits of RUS electric and telecommunications cooperatives and commercial telecommunications borrowers.

§ 1773.4 Borrower responsibilities.

(a) *Selection of a qualified CPA*. The borrower's board of directors is responsible for the selection of a qualified CPA that meets the requirements set forth in § 1773.5. When selecting a CPA, the borrower should consider, among other matters:

(1) The qualifications of CPAs available to do the work;

(2) The CPA's experience in performing audits of utilities; and

(3) The CPA's ability to complete the audit and submit the reports and management letter within 90 days of the as of audit date.

(b) *Board approval of selection*. The board's approval of a CPA must be recorded by a board resolution that states:

(1) The CPA meets RUS' qualifications to perform an audit; and

(2) The borrower and CPA will enter into an audit agreement in accordance with § 1773.6.

(c) *Notification of selection*. When the initial selection or subsequent change of a CPA by a borrower has been made, the borrower must notify RUS, in writing, at least 90 days prior to the as of audit date.

(1) RUS will notify the borrower, in writing, within 30 days of the date of receipt of such notice, if the selection or change in CPA is not satisfactory.

(2) Notification to RUS that the same CPA has been selected for succeeding audits of the borrower's financial statements is not required; however, the procedures outlined in this part must be followed for each new CPA selected, even though such CPA may previously have been approved by RUS to audit records of other RUS borrowers. Changes in the name of a CPA firm are considered to be a change in the CPA.

(d) *Audit engagement letter*. The borrower must enter into an audit engagement letter with the CPA that complies with § 1773.6.

(e) *Debarment certification*. The borrower is responsible for the receipt, from the selected CPA, of a lower tier covered transaction certification, as required under the provisions of Executive Orders 12549 and 12689, Debarment and Suspension, and any rules or regulations issued thereunder.

(f) *Submission of auditor's report*. The borrower must submit to RUS the required auditor's report, report on compliance and on internal control over financial reporting, and management letter as set forth in § 1773.21.

(1) An annual auditor's report, report on compliance and on internal control over financial reporting, and management letter that fail to meet the requirements detailed in this part will be returned to the borrower with a written explanation of noncompliance.

(2) The borrower must, within 60 days of the date of the letter detailing the noncompliance, submit corrected reports to RUS.

(3) If corrected reports are not received within 60 days of the date of the letter detailing the noncompliance, RUS may notify the borrower that a default has occurred under its security instrument or take other appropriate action. The default notice will set forth the period of time during which the default will be remedied.

(g) *Submission of plan of corrective action*. The borrower must submit written comments to RUS on the findings and recommendations in the auditor's report, report on compliance and on internal control over financial reporting, and management letter. The borrower must also submit to RUS:

(1) A written plan for corrective action taken or planned; and

(2) Comments on the status of corrective action taken on previously reported findings and recommendations. If corrective action is not necessary, a written statement describing the reason it is not should accompany the auditor's report.

§ 1773.5 Qualifications of CPA.

For purposes of the RUS standard security instrument, any CPA that meets the qualifications criteria of this section and enters into an audit agreement with the borrower that complies with § 1773.6, will be considered satisfactory to RUS.

(a) *Certification*. The accountant that audits the financial statements of an RUS borrower must be a CPA in good standing of some state. The CPA does not have to be licensed by the state in which the borrower is located; however, the CPA must abide by the rules and regulations of professional conduct promulgated by the accountancy board of the state in which the borrower is located.

(b) *Independence*. The CPA must be independent. A CPA will be considered independent if the CPA:

(1) Meets the standards for independence contained in the AICPA Code of Professional Conduct in effect at the time the CPA's independence is under review;

(2) Does not have and has not had any direct financial interest or any material indirect financial interest in the borrower during the period covered by the audit; and

(3) Is not and was not, during the period under audit, connected with the borrower as a promoter, underwriter, trustee, director, officer, or employee.

(c) *Peer review requirement*. The CPA must belong to and participate in a peer review program, and must have undergone a satisfactory peer review of the accounting and audit practice conducted by an approved peer review program under paragraph (c)(4) of this section, unless a waiver is granted under paragraph (c)(6) of this section. The reviewing organization must not be affiliated with or have had its most recent peer review conducted by the organization currently being reviewed (reciprocal reviews). After the initial peer review has been performed, the CPA must undergo a peer review of the accounting and audit practice within 36 months of the issuance of the previous peer review or such additional times as designated by the peer review executive committee.

(1) A CPA that receives an unqualified peer review report will be satisfactory to RUS provided that the CPA meets the other criteria set forth in this section.

(2) If a CPA receives a qualified or adverse peer review report, the CPA must undergo a second peer review within 18 months of the date of the qualified or adverse report. A CPA that receives an unqualified second peer review report will be satisfactory to RUS provided that the CPA meets the other criteria set forth in this section.

(3) A CPA that receives a second qualified or adverse peer review report will not be satisfactory to RUS.

(4) Approved peer review programs. The following peer review programs are approved by RUS:

(i) The peer review programs conducted by the AICPA;

(ii) The peer review program conducted by the regulated audit program group of the National Conference of CPA Practitioners; and

(iii) An independent peer review program that, in RUS' determination, requires its members to:

(A) Ensure that the CPA can legally engage in the practice of certified public accounting;

(B) Adhere to the quality control standards established by the AICPA;

(C) Submit to peer reviews of the CPA's accounting and audit practice every 36 months or at such additional times as designated by its own executive committee; and

(D) Ensure that all professionals in the firm, including CPAs and nonCPAs, take part in the qualifying continuing professional education requirements of GAGAS, as set forth in paragraphs (c)(4)(iii)(D)(*1*) and (c)(4)(iii)(D)(*2*). A qualified continuing professional education course is one that meets the standards of the AICPA.

(*1*) An auditor responsible for planning, directing, conducting, or reporting on government audits must complete, every two years, at least eighty hours of continuing education and training which contributes to the auditor's professional proficiency. At least twenty hours must be completed in any one year of the two-year period; and

(*2*) An individual responsible for planning, directing, and conducting substantial portions of the field work, or reporting on the government audit must complete at least 24 of the 80 hours of continuing education and training in subjects directly related to the government environment and to government auditing. If the audited entity operates in a specific or unique environment, auditors must receive training that is related to that environment.

(5) Submission of reports. The CPA must submit to the Assistant Administrator, PARA, a copy of any peer review report and accompanying letter of comment, if any, within 60 days of the date such report and letter of comment are released by the peer review group.

(i) If the peer review report indicates that a follow-up review will be made, the CPA must submit subsequent reports to the Assistant Administrator, PARA, within 60 days of the date such reports are released by the peer review group.

(ii) A peer review report must be submitted to the Assistant Administrator, PARA, at least once every 36 months, or more frequently, if required by the peer review program.

(iii) A copy of the peer review report, accompanying letter of comment, and the partners' inspections must be made available to OIG, upon request.

(6) Waiver of the peer review requirement.

(i) A CPA may request that the Administrator, RUS, waive the peer review requirement. To be eligible for a waiver, the following criteria must be met:

(A) The firm has been in existence for less than 1 year from the date of the request and has not been previously organized under a different name;

(B) One of the partners organizing the firm has previously, within 18 months preceding the request, worked for a firm that has been peer reviewed and the partner was partner-in-charge of audits of RUS borrowers in the previous firm;

(C) The firm has enrolled in an approved peer review program; and

(D) The firm agrees to have the peer review conducted within 18 months of the date of the RUS waiver.

(ii) Waiver requests must address each of the criteria in paragraph (c)(6)(i) of this section and should be submitted to the Assistant Administrator, Program Accounting and Regulatory Analysis.

§ 1773.6 Auditor communication.

(a) During the planning stages of a financial statement audit, GAGAS and AICPA standards require the auditor to communicate certain information regarding the nature and extent of testing and reporting on compliance with laws and regulations and internal control over financial reporting. The communication must include the nature of any additional testing of compliance and internal control required by laws and regulations or otherwise requested, and whether the auditors are planning to provide opinions on compliance with laws and regulations and internal control over financial reporting. This communication must take the form of an audit engagement letter prepared by the CPA and formally accepted by the board of directors or an audit committee representing the board of directors. The engagement letter must also encompass those items prescribed in SAS 84, entitled “Establishing an Understanding with the Client”. It must also include the following:

(1) The borrower and the CPA acknowledge that the audit is being performed and the auditor's report, report on compliance and on internal control over financial reporting, and management letter are being issued in order to enable the borrower to comply with the provisions of RUS' security instrument;

(2) The borrower and CPA acknowledge that RUS will consider the borrower to be in violation of its security instrument with RUS if the borrower fails to have an audit performed and documented in compliance with GAGAS and this part;

(3) The CPA represents that he/she meets the requirements under this part to be satisfactory to RUS;

(4) The CPA will perform the audit and will prepare the auditor's report, report on compliance and on internal control over financial reporting, and management letter in accordance with the requirements of this part;

(5) The CPA will document the audit work performed in accordance with GAGAS, the professional standards of the AICPA, and the requirements of this part;

(6) The CPA will make all audit-related documents, including auditor's reports, workpapers, and management letters available to RUS or its representatives (OIG and GAO), upon request, and will permit the photocopying of all audit-related documents; and

(7) The CPA will follow the requirements of reporting fraud and illegal acts as outlined in § 1773.9.

(b) The audit agreement may include such additional terms and conditions as the CPA and borrower deem appropriate, including, but not limited to:

(1) The CPA will report all audit findings to the board of directors as required in § 1773.20(b); and

(2) The auditor's report, report on compliance and on internal controls over financial reporting, and management letter with copies for transmittal to RUS, and supplemental lenders, if applicable, will be submitted to the borrower's board of directors within 90 days of the as of audit date;

(c) A copy of the audit agreement must be available at the borrower's office for inspection by RUS personnel. One copy of the current audit agreement must be maintained in the CPA's workpapers or permanent file.

§ 1773.7 Audit standards.

(a) The audit must be performed in accordance with GAGAS and this part. The audit must be performed in accordance with GAGAS in effect at the audit date unless the borrower is directed otherwise, in writing, by RUS.

(b) The audit must include such tests of the accounting records and such other auditing procedures that are sufficient to enable the CPA to express an opinion on the financial statements and to issue the required reports on compliance and on internal control over financial reporting and the management letter.

(c) Audit scope limitation.

(1) The borrower will not limit the scope of the audit to the extent that the CPA is unable to meet RUS' audit requirements or to provide an unqualified opinion that the financial statements are presented fairly in conformity with GAAP.

(2) The security instrument provision requiring the submission of a report of the audit is not satisfied if the CPA must qualify the opinion in the auditor's report due to limitations placed on the scope of the audit by the borrower.

(3) If the CPA determines during the audit that an unqualified opinion cannot be issued due to a scope limitation imposed by the borrower, the CPA should use professional judgment to determine what levels of the borrower's management should be informed.

(4) After informing the borrower's management, if the scope limitation is not adequately resolved, the CPA should immediately contact the AA-PARA, RUS, U.S. Department of Agriculture, Washington, DC 20250-1523. The AA-PARA will endeavor to resolve the matter with the borrower.

§ 1773.8 Audit date.

(a) The annual audit must be performed as of the end of the same calendar month each year unless prior approval to change the as of audit date is obtained, in writing, from RUS.

(1) A borrower may request a change in the as of audit date by writing to the AA-PARA at least 60 days prior to the newly requested as of audit date.

(2) The time period between the prior as of audit date and the newly requested as of audit date must be no longer than twenty-four months. For example, a borrower that wishes to change its as of audit date from December 31, 20X1, to June 30, must make the change effective no later than June 30, 20X3.

(b) Comparative financial statements must be prepared and audited for the twelve months ending as of the new audit date and for the twelve months immediately preceding that period.

(c) A borrower that changes its as of audit date from December 31, 20X1, to June 30, 20X3, must have the CPA report on statements in the following manner:

Previously Issued Statements	Statements Prepared as of New Audit Date
12/31/20X1; 12/31/20X0 (Statements need not be reissued)	6/30/20X3; 6/30/20X2

§ 1773.9 Disclosure of fraud, illegal acts, and other noncompliance.

(a) In accordance with GAGAS, the auditor must design the audit to provide reasonable assurance of detecting fraud that is material to the financial statements and material misstatement resulting from direct and material illegal acts, and noncompliance with the provisions of contracts or grant agreements that could have a direct and material effect on financial statement amounts.

(b) If specific information comes to the auditor's attention that provides evidence concerning the existence of possible illegal acts that could have a material indirect effect on the financial statement or material noncompliance with the provisions of contracts or grant agreements that could have a material indirect effect on the financial statements, auditors should apply audit procedures specifically directed to ascertaining whether an illegal act or noncompliance with provisions of contract or grant agreements has occurred.

(c) Pursuant to the terms of its audit engagement letter with the borrower, the CPA must immediately report, in writing, all instances of fraud and all indications or instances of illegal acts, whether material or not, to:

(1) The president of the borrower's board of directors;

(2) The Assistant Administrator, PARA; and

(3) OIG, as follows:

(i) For the States of Delaware, District of Columbia, Maryland, Pennsylvania, Virginia, West Virginia, Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, New York, Puerto Rico, Rhode Island, Vermont and the Virgin Islands, report to USDA-OIG-Audit, Northeast Region, Regional Inspector General, 6505 Belcrest Road, room 428-A, Hyattsville, Maryland 20782;

(ii) For the States of Alabama, Florida, Georgia, Kentucky, Mississippi, North Carolina, South Carolina, and Tennessee, report to USDA-OIG-Audit, Southeast Region, Regional Inspector General, 401 W. Peachtree Street, NW., room 2328, Atlanta, Georgia 30365-3520;

(iii) For the States of Illinois, Indiana, Michigan, Minnesota, Ohio, and Wisconsin, report to USDA-OIG-Audit, Midwest Region, Regional Inspector General, 111 N. Canal Street, Suite 1130, Chicago, Illinois 60606;

(iv) For the States of Arkansas, Louisiana, New Mexico, Oklahoma, and Texas, report to USDA-OIG-Audit, Southwest Region, Regional Inspector General, 101 South Main, room 324, Temple, Texas 76501;

(v) For the States of Colorado, Iowa, Kansas, Missouri, Montana, Nebraska, North Dakota, South Dakota, Wyoming, and Utah, report to USDA-OIG-Audit, Great Plains Region, Regional Inspector General, P.O. Box 293, Kansas City, Missouri 64141; and

(vi) For the States of Alaska, Arizona, California, Hawaii, Idaho, Nevada, Oregon, Territory of Guam, Trust Territories of Pacific, and Washington, report to USDA-OIG-Audit, Western Region, Regional Inspector General, 555 Battery Street, room 511, San Francisco, California 94111.

§ 1773.10 Access to audit-related documents.

Pursuant to the terms of the audit agreement, the CPA must make all audit-related documents, including auditors' reports, workpapers, and management letters available to RUS, or its designated representative, upon request and must permit RUS, or its designated representative, to photocopy all audit-related documents.

§§ 1773.11-1773.19 [Reserved]

Subpart C - RUS Requirements for the Submission and Review of the Auditor's Report, Report on Compliance and on Internal Control over Financial Reporting, and Management Letter

§ 1773.20 CPA's submission of the auditor's report, report on compliance and on Internal controls over financial reporting, and management letter.

(a) *Time limit*. As soon as possible after completion of the audit, but within 90 days of the as of audit date, the CPA should deliver the auditor's report, report on compliance and on internal control over financial reporting, and management letter to the president of the borrower's board of directors. As a minimum, copies should be provided for each member of the board of directors and the manager. Further, three copies must be provided to the borrower for transmittal to RUS.

(b) *Communication with the board of directors*. In addition to providing sufficient copies of the auditor's report, report on compliance and on internal control over financial reporting, and management letter for each member of the borrower's board of directors, RUS requires that the CPA report all audit findings to the borrower's board of directors. RUS recommends that audit findings be communicated orally; however, the communication may be oral or written, at the borrower's discretion. If the information is communicated orally, the CPA must document the communication by appropriate memoranda or notations in the workpapers. If the CPA communicates in writing, a copy of the written communication must be included in the CPA's audit workpapers or permanent file.

(c) *Matters to be communicated*. Matters communicated to the board of directors must include, but are not limited to the matters to be communicated to the audit committee as prescribed in SAS No. 61, entitled "Communication with Audit Committee",:

(1) The initial selection of and changes in significant accounting policies;

(2) The methods used to account for significant or unusual transactions and the effects of significant accounting policies in controversial or emerging areas;

(3) The process utilized by management to formulate significant accounting estimates and the basis for the CPA's conclusions regarding the reasonableness of these estimates;

(4) Audit findings and recommendations, including audit adjustments that either individually or in the aggregate have a significant effect on the borrower's financial statements;

(5) The CPA's responsibility for other information presented with the audited financial statements, any audit procedures performed, and the results thereof;

(6) Any disagreements with management, whether or not satisfactorily resolved, concerning matters that individually or in the aggregate may be significant to the borrower's financial statements or the auditor's report, report on compliance and on internal control over financial reporting, or management letter;

(7) Significant matters that were the subject of consultations with other accountants;

(8) Significant issues discussed with management with regard to the initial or recurring retention of the CPA; and

(9) Any serious difficulties encountered in dealing with management during the performance of the audit.

§ 1773.21 Borrower's review and submission of the auditor's report, report on compliance and on internal control over financial reporting, and management letter.

(a) The borrower's board of directors should note and record receipt of the auditor's report, report on compliance and on internal control over financial reporting, and management letter and any action taken in response to the reports or management letter in the minutes of the board meeting at which such reports and management letter are presented.

(b) The borrower must furnish RUS with three copies of the auditor's report, report on compliance and on internal control over financial reporting, and management letter within 120 days of the as of audit date. Any provision in RUS' security instrument that requires such documents to be furnished to RUS in a shorter period of time may be disregarded.

(c) The borrower must furnish RUS with three copies of its plan for corrective action, if any, within 180 days of the as of audit date.

(d) The borrower must furnish RUS, within 120 days of the as of audit date, with a copy of each special report, summary of recommendations or similar communications, if any, received from the CPA as a result of the audit.

(e) All required submissions to RUS described in paragraphs (a) through (d) of this section should be sent to: Assistant Administrator, Program Accounting and Regulatory Analysis, Stop 1523, 1400 Independence Ave., SW, Washington, DC 20250-1523.

§§ 1773.22.-1773.29 [Reserved]

Subpart D - RUS Reporting Requirements

§ 1773.30 General.

(a) The CPA must prepare the following:

(1) An auditor's report, examples of which are set forth in appendices A, exhibit 1 (Electric), and B, exhibit 1 (Telecommunications) of this Bulletin 1773-1;

(2) A report on compliance and on internal control over financial reporting, examples of which are set forth in appendices A, exhibits 2 and 3 (Electric) and B, exhibits 2 and 3 (Telecommunications) of this Bulletin 1773-1; and

(3) A management letter, an example of which is set forth in appendices A, exhibit 5 (Electric), and B, exhibit 5 (Telecommunications) of this Bulletin 1773-1.

(b) The CPA should deliver the auditor's report, report on compliance and on internal control over financial reporting, and management letter (with copies as required in § 1773.20) to the borrower as soon as possible after completion of the audit but not more than 90 days after the as of audit date.

§ 1773.31 Auditor's report.

The CPA must prepare a written report on comparative balance sheets, statements of revenue and patronage capital (or income and retained earnings, depending upon the structure of the borrower) and statements of cash flows. This report must be signed by the CPA, cover all statements presented, and refer to the separate report on compliance and on internal control over financial reporting issued in conjunction with the auditor's report. The auditor's report should also state that the report on compliance and on internal control over financial reporting is an integral part of a GAGAS audit, and in considering the results of the audit, this report should be read along with the auditors report on the financial statements.

§ 1773.32 Report on compliance and on internal control over financial reporting.

As required by GAGAS, the CPA must prepare a written report describing the auditors testing of compliance with applicable laws, regulations, contracts, and grants and on internal control over financial reporting and present the results of those tests. This report must be signed by the CPA and must include, as a minimum:

(a) The scope of the CPA's testing of compliance with laws and regulations and internal control over financial reporting including whether or not the tests performed provided sufficient evidence to support an opinion on compliance or internal control over financial reporting and whether the CPA is providing such opinions;

(b) If conditions believed to be material weaknesses considered to be reportable conditions are disclosed, the report should identify the material weaknesses that have come to the CPA's attention;

(c) If no reportable instances of non-compliance and no reportable conditions were found, the CPA must issue a report as illustrated in appendices A, exhibit 2 (Electric), and B, exhibit 2 (Telecommunications) of this Bulletin 1773-1;

(d) If material instances of noncompliance and reportable conditions are identified, the CPA must issue a report as illustrated in appendices A, exhibit 3 (Electric), and B, exhibit 3 (Telecommunications) of this Bulletin 1773-1;

(e) Other nonmaterial instances of noncompliance should not be disclosed in the report on compliance and on internal controls over financial reporting, but should be reported in a separate communication to the board of directors, preferably in writing. All such communications must be documented in the workpapers and submitted to RUS in compliance with section 1773.21.

(f) If the CPA has issued a separate letter detailing immaterial instances of noncompliance, the report on compliance and on internal controls over financial reporting must be modified to include a statement such as:

We noted certain immaterial instances of noncompliance, which we have reported to the management of (borrower's name) in a separate letter dated (Month, day, year).

(g) If the CPA has issued a separate letter to the management to communicate other matters involving the design and operation of the internal control over financial reporting, the report on compliance and on internal control over financial reporting must be modified to include a statement such as:

However, we noted other matters involving the internal control over financial reporting that we have reported to the management of (borrower's name) in a separate letter dated (month, day, year).

(h) The report must contain the status of known but uncorrected significant or material findings and recommendations from prior audits that affect the current audit objective.

§ 1773.33 Management letter.

The CPA must prepare a management letter that includes, at a minimum, comments on:

(a) *Audit procedures*. State whether the audit has been performed in accordance with this part;

(b) *Special reports.* State whether any special reports, summaries of recommendations, or similar communications were furnished to the borrower's management during the course of the audit or during interim audit work, and provide a description of the information furnished;

(c) *Accounting and records.* Comment on the adequacy and effectiveness of the borrower's accounting procedures, discuss the general condition of the records, and outline any recommendations for improvement. Comment on the adequacy and fairness of the methods used in accumulating and recording labor, material, and overhead costs, and the distribution of these costs to construction, retirement, and maintenance or other expense accounts, and where appropriate, include:

(1) Whether continuing property records (CPRs) have been established, are updated on a current basis, at least annually, and are reconciled with the controlling general ledger plant accounts;

(2) Whether construction clearing accounts are cleared promptly of costs of completed construction to the proper classified plant accounts and whether depreciation was accrued on such completed construction from the date the plant was placed in service;

(3) Whether retirements of plant are currently and systematically recorded and properly priced;

(4) Whether all costs associated with retirements of plant are properly accounted for in the accumulated provision for depreciation accounts and comment on any unusual charges or credits to such accounts; and

(5) Whether RUS approval was obtained for the sale, lease or transfer of capital assets secured under the mortgage when approval is required, and whether proceeds from sale or lease of plant, material or scrap were handled in conformance with RUS requirements.

(d) *Materials control*. Comment on the adequacy of the control over materials and supplies.

(e) *Compliance with RUS loan and security instrument provisions.* State whether the following provisions of RUS' loan and security instruments have been complied with:

(1) For electric borrowers, provisions relating to:

(i) The requirement for a borrower to obtain written approval of mortgagees to enter into any contract for the management, operation, or maintenance of the borrower’s system if the contract covers all or substantially all (90 percent) of the electric system. For purposes of this part, the following contracts shall be deemed as requiring RUS approval:

(A) Management contracts in which the borrower has contracted to have another borrower or other entity manage its affairs;

(B) Management contracts in which the borrower has contracted to manage another borrower or other utility system;

(C) Operations and maintenance contracts in which the borrower has contracted to have another borrower or other entity operate and/or maintain all or substantially all (90 percent) of the physical plant facilities of the borrower;

(D) Operations and maintenance contracts in which the borrower has contracted to operate and maintain the physical plant facilities of another borrower or other utility system; and

(ii) The requirement for a borrower to prepare and furnish mortgagees annual financial and statistical reports on the borrower's financial condition and operations. For borrowers with a December 31 year end, the CPA must state whether the information represented by the borrower as having been submitted to RUS in its most recent December 31 RUS Form 7 or Form 12 is in agreement with the borrower's audited records. For borrowers with a year-end other than December 31, the CPA must state whether the information appears reasonable based upon the audit procedures performed. If the borrower represents that an amended report has been filed as of December 31, the comments must relate to the amended report.

(2) For telecommunications borrowers, provisions relating to the requirement for a borrower to obtain written approval of the mortgagees to enter into:

(i) Any contract, agreement or lease between the borrower and an affiliate other than as allowed under 7 CFR part 1744, subpart E;

(ii) The requirement for a borrower to prepare and furnish mortgagees annual financial and statistical reports on the borrower's financial condition and operations. For borrowers with a December 31 year end, the CPA must state whether the information represented by the borrower as having been submitted to RUS in its most recent December 31 RUS Form 479 is in agreement with the borrower's audited records. For borrowers with a year end other than December 31, the CPA must state whether the information appears reasonable based on the audit procedures performed. If the borrower represents that an amended report has been filed as of December 31, the comments must relate to the amended report.

(f) *Related party transactions*. State whether all material related party transactions have been disclosed in the notes to the financial statements in accordance with SFAS No. 57, entitled "Related Party Disclosures". If the audit did not disclose any related party transactions considered to be material, either individually or in the aggregate, so state;

(g) *Depreciation rates.* For electric borrowers, comment when the depreciation rates used in computing monthly accruals are not in compliance with RUS requirements (See RUS Bulletin 183-1, Depreciation Rates and Procedures), which require the use of depreciation rates that are within the ranges established by RUS for each primary plant account, or with the requirements of the State regulatory body having jurisdiction over the borrower's depreciation rates; and

(h) *Deferred debits and deferred credits.* For electric borrowers, provide a detailed analysis of the totals reported as deferred debits and deferred credits, including, but not limited to, margin stabilization plans, revenue deferral plans, and expense deferrals. The CPA must state whether RUS has approved, in writing, each regulatory asset and liability.

(i) *Investments*. For electric and telecommunications borrowers, provide a detailed schedule of all investments in subsidiary and affiliated companies accounted for on either the cost or equity basis. This requirement includes investments in corporations, limited liability corporations and partnerships, joint ventures, etc. For all investments list the name of the entity, ownership percentage, and the principal business in which the entity is engaged. For investments recorded on the cost basis include the original investment, advances, dividends declared or paid in the current and prior years and the net investment. For investments recorded on the equity basis include the ownership percentage, original investment, advances, and current and prior years’ earnings and losses, including accumulated losses in excess of the original investment.

§§ 1773.34-1773.37 [Reserved]

Subpart E - RUS Required Audit Procedures and Documentation

§ 1773.38 Scope of engagement.

(a) RUS requires that the audit procedures set forth in §§ 1773.39 through 1773.45 be performed annually by the CPA during the audit of the RUS borrowers' financial statements, which audit procedures may be in addition to the conduct of a GAGAS audit.

(b) The CPA must exercise professional judgment in determining whether any auditing procedures in addition to those mandated by GAGAS or this part should be performed in order to afford a reasonable basis for rendering the auditor's report, report on compliance and on internal control over financial reporting, and management letter.

§ 1773.39 Utility plant and accumulated depreciation.

(a) *General*. The audit of these accounts must include tests of additions, replacements, retirements, and changes. Based upon the CPA's determination of materiality, an appropriate sample of transactions must be selected for testing. The CPA's workpapers must document that he/she:

(1) Examined direct labor and material transactions to determine whether the borrower's accounting records reflect a complete accumulation of costs;

(2) Examined indirect costs and overhead charges to determine if they conform to the Uniform System of Accounts;

(3) Reviewed the costs of completed construction and retirement projects to determine if they were cleared promptly from the work in progress accounts to the classified plant in service accounts and the related depreciation reserves;

(4) Examined direct purchases of special equipment and general plant;

(5) Determined the degree of accuracy and control of costing retirements, including tests of salvage and removal costs;

(6) Reviewed the borrower's work order procedures; and

(7) Reviewed depreciation rates for adequate support, compared them to RUS guidelines, and determined if they are in compliance.

(b) *Construction work in progress.*

(1) The workpapers must include a summary of open work orders reconciled to the general ledger. The CPA must note on the summary any unusual or nontypical projects.

(2) Based upon the CPA's determination of materiality, an appropriate sample of work orders must be selected for testing. The CPA's workpapers must document that he/she:

(i) Reviewed equipment purchases charged to work orders, including payments and receiving reports;

(ii) Reviewed contracts showing the scope of the work, the nature of the contract, the contract amount, and scheduled payments and reviewed supporting documents to determine that all services contracted for were in fact rendered;

(iii) Reviewed time cards and pay rates for several employees who allocate their time to work orders;

(iv) Reviewed the nature of material and supplies issued to the project, traced amounts and quantities to supporting documents, and reviewed the reasonableness of clearing rates for assignment of stores expense to the work order;

(v) Reviewed the accuracy of the computation of overheads applied to the work order; and

(vi) Reviewed other costs charged to the work order for support and propriety.

(3) Based upon the CPA's determination of materiality, an appropriate sample of completed contracts must be selected for testing. The CPA's workpapers must document that he/she:

(i) Scheduled payments to contractors and traced to verify payments and supporting invoices;

(ii) Traced contract costs to final closeout documents, to the general ledger, and to the continuing property records; and

(iii) Verified the costs of owner furnished materials, if applicable.

(4) The CPA must review the borrower's procedures for unitization and classification of work order and contract costs. Based upon the CPA's determination of materiality, an appropriate sample of transactions must be selected for testing. The CPA's workpapers must document that he/she:

(i) Reviewed the tabulation of record units for construction from the work order staking sheets to the tabulation of record units, to the unitization sheets, and to the continuing property records;

(ii) Reviewed the procedures for unitizing and distributing costs of completed construction to the plant accounts;

(iii) Verified that standard costs were being used;

(iv) Evaluated the basis for development of standard costs; and

(v) Determined that costs of completed construction were cleared promptly from work in progress accounts.

(c) *Continuing property records.* Based upon the CPA's determination of materiality, an appropriate sample of transactions must be selected for testing. The CPA's workpapers must document that he/she:

(1) Determined whether the subsidiary plant records agree with the controlling general ledger plant accounts;

(2) Noted differences in the workpapers; and

(3) Commented, in the management letter, on any discrepancies.

(d) *Retirement work-in-progress.* Based upon the CPA's determination of materiality, an appropriate sample of transactions must be selected for testing. The CPA's workpapers must document that he/she:

(1) Determined that plant retirements are currently and systematically recorded and priced on the basis of the continuing property records, and determined that costs of removal have been properly accounted for;

(2) Explained the method used in computing the cost of units of plant retired if continuing property records have not been established and determined whether costs appeared reasonable; and

(3) Determined the manner in which net losses due to retirements were accounted for and traced clearing entries to the depreciation reserve, the plant accounts, and the continuing property records.

(e) *Provision for accumulated depreciation.* The CPA's workpapers must include an analysis of transactions. Based upon the CPA's determination of materiality, an appropriate sample of transactions must be selected for testing. The CPA's workpapers must document that he/she:

(1) Verified the depreciation accruals for the period, including the depreciation base;

(2) Reviewed the basis of the depreciation rates, any change in rates and the reason therefor, and, if appropriate, determined whether the rates are in compliance with RUS requirements or with the requirements of the state regulatory body having jurisdiction over the borrower's depreciation rates;

(3) Reviewed salvage and removal costs; and

(4) Searched for unrecorded retirements.

(f) *Other reserves*. The CPA's workpapers must include an account analysis for all other material plant reserves, such as the reserve for the amortization of plant acquisition adjustments. Based upon the CPA's determination of materiality, an appropriate sample of transactions must be selected for testing. The CPA's workpapers must document that appropriate tests of transactions were performed.

(g) *Narrative*. The CPA must prepare and include in the workpapers a comprehensive narrative on the scope of work performed, observations made, and conclusions reached. Specific matters covered in this narrative must include:

(1) The nature of construction and other additions;

(2) The control over, and the accuracy of pricing retirements;

(3) The accuracy of distributing costs to classified utility plant accounts;

(4) An evaluation of the method of:

(i) Capitalizing the direct loadings on labor and material costs;

(ii) Distributing transportation costs and other expense clearing accounts; and

(iii) Capitalizing overhead costs;

(5) The tests of depreciation;

(6) A review of agreements such as those relating to acquisitions, property sales, and leases which affect the plant accounts; and

(7) Notations, if applicable, of RUS approval of property sales and the propriety of the disposition of the proceeds.

§ 1773.40 Regulatory assets.

The CPA's workpapers must document whether all regulatory assets comply with the requirements of SFAS No. 71. For electric borrowers only, the CPA's workpapers must document whether all regulatory assets have received RUS approval.

§ 1773.41 Extraordinary retirement losses.

The CPA's workpapers must contain an analysis of retirement losses, including any required approval by a regulatory commission with jurisdiction in the matter, or RUS, in the absence of commission jurisdiction.

§ 1773.42 Clearing accounts.

The CPA's workpapers must contain an analysis of all clearing accounts. Based upon the CPA's determination of materiality, an appropriate sample of transactions should be selected for testing. The CPA's workpapers must document that transactions were reviewed for proper allocation between expense and capital accounts.

§ 1773.43 Capital and equity accounts.

(a) *Capital stock*. For privately owned companies, the workpapers must include analyses of all stock transactions during the audit period. Based upon the CPA's determination of materiality, an appropriate sample of transactions must be selected for testing. The CPA's workpapers must document that he/she:

(1) Reviewed the subsidiary records and reconciled them to the general ledger control account;

(2) Reviewed authorizations and issuances or redemptions of capital stock for proper approvals by the board of directors, stockholders, and regulatory commissions;

(3) Determined that transactions were made in accordance with the appropriate provisions of the articles of incorporation, bylaws, and RUS loan documents; and

(4) Determined that transactions were recorded in accordance with the Uniform System of Accounts.

(b) *Memberships*. For cooperative organizations, the workpapers must include an analysis of the membership transactions during the audit period. Based upon the CPA's determination of materiality, an appropriate sample of transactions must be selected for testing. The CPA's workpapers must document that he/she:

(1) Reviewed the subsidiary records and reconciled them to the general ledger control account; and

(2) Determined that transactions were made in accordance with the appropriate provisions of the articles of incorporation, bylaws, and RUS loan documents.

(c) *Patronage capital, retained earnings, margins, and other equities.* The workpapers must include an analysis of the patronage capital, retained earnings, margins and other equities, and any related reserve accounts. Based upon the CPA's determination of materiality, an appropriate sample of transactions must be selected for testing. The CPA's workpapers must document that he/she:

(1) Determined that the transactions were made in accordance with the appropriate provisions of the articles of incorporation, bylaws, RUS loan documents, Uniform System of Accounts, or orders of regulatory commissions;

(2) Traced payments to underlying support; and

(3) Determined whether, under the terms of the RUS security instrument, restrictions of retained earnings or margins are required and, if so, whether they have been properly recorded.

§ 1773.44 Long-term debt.

The CPA's workpapers must document that he/she:

(a) Confirmed RUS, FFB, and RTB debt to the appropriate confirmation schedule (RUS Form 690, Confirmation Schedule Obligation to the FFB as of; or Form 691, Confirmation Schedule-Long-term Obligation to RUS as of; or RTB Form 12, Confirmation Schedule);

(b) Confirmed other long-term debt directly with the lender;

(c) Examined notes executed or canceled during the audit period; and

(d) Tested accrued interest computations.

§ 1773.45 Regulatory liabilities.

The CPA's workpapers must document whether all regulatory liabilities comply with the requirements of SFAS No. 71. For electric borrowers only, the CPA's workpapers must document whether all regulatory liabilities have received RUS approval.

§§ 1773.46-1773.49 [Reserved]

APPENDIX A

SAMPLE REPORTS FOR AN ELECTRIC COOPERATIVE

Appendix A includes an example of an auditor's report, report on compliance and on internal controls over financial reporting, financial statements and accompanying notes, and management letter for an electric distribution cooperative. The sample auditor's report is intended as a guide only and, while it is recommended that the format be followed, each auditor's report should be prepared to adequately cover the circumstances. To the extent possible, it should be used as a guide in preparing auditors' reports for other types of electric borrowers. For power supply borrowers and for distribution borrowers with production or transmission plant, the same general format should be followed. However, the Statement of Revenue and Patronage Capital must be expanded to show separate totals for operations expenses and maintenance expenses for each class of production plant and for transmission plant.

EXHIBIT 1 - SAMPLE AUDITOR'S REPORT

Certified Public Accountants
1600 Main Street
City, State 24105

The Board of Directors
Center County Electric Energy Association, Inc.

Independent Auditor's Report

We have audited the accompanying balance sheets of Center County Electric Energy Association, Inc. as of December 31, 20X1 and 20X0, and the related statements of revenue and patronage capital, and cash flows for the years then ended. These financial statements are the responsibility of Center County Electric Energy Association, Inc.'s management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Center County Electric Energy Association, Inc. as of December 31, 20X1 and 20X0, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 2, 20X2, on our consideration of Center County Electric Energy Association, Inc.'s internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Certified Public Accountants
March 2, 20X2

EXHIBIT 2

Sample Report on Compliance and on Internal Control over Financial Reporting, the CPA found No Reportable Instances of Noncompliance and No Material Weaknesses (No Reportable Conditions Identified)

Certified Public Accountants
1600 Main Street
City, State 24105

The Board of Directors
Center County Electric Energy Association, Inc.

We have audited the financial statements of Center County Electric Energy Association, Inc. as of and for the years ended December 31, 20X1 and 20X0, and have issued our report thereon dated March 2, 20X2. We conducted our audits in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether Center County Electric Energy Association, Inc.'s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards.* [*If the CPA has issued a separate letter to the management detailing immaterial instances of noncompliance, modify this paragraph to include a statement such as the following: However, we noted certain immaterial instances of noncompliance which we have reported to the management of Center County Electric Energy Association, Inc. in a separate letter dated March 2, 20X2*.]

Internal Control Over Financial Reporting

In planning and performing our audit we considered Center County Electric Energy Association, Inc.'s internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the 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 material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the 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. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. [*If the CPA has issued a separate letter to management to communicate other matters involving the design and operation of the internal control over financial reporting, modify this paragraph to include a statement such as the following: However, we noted other matters involving the internal control over financial reporting which we have reported to the management Center County Electric Energy Association,Inc. in a separate letter dated March 2, 20X2*.]

This report is intended solely for the information and use of the audit committee, management, the Rural Utilities Service, and supplemental lenders, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Certified Public Accountants
March 2, 20X2

EXHIBIT 3

Sample Report on Compliance and on Internal Control over Financial Reporting, the CPA Found Reportable Instances of Noncompliance and Reportable Conditions Were Identified

Certified Public Accountants
1600 Main Street
City, State 24105

The Board of Directors
Center County Electric Energy Association, Inc.

We have audited the financial statements of Center County Electric Energy Association, Inc. as of and for the years ended December 31, 20X1 and 20X0, and have issued our report thereon dated March 2, 20X2. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether Center County Electric Energy Association, Inc.'s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards*. [*A description of the findings should be included in the report*.][*If the CPA has issued a separate letter to the management detailing immaterial instances of noncompliance, modify this paragraph to include a statement such as the following: We also noted certain immaterial instances of noncompliance which we have reported to the management Center County Electric Energy Association, Inc. in a separate letter dated March 2, 20X2*.]

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Center County Electric Energy Association, Inc.'s internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affects Center County Electric Energy Association, Inc.'s ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. [*A description of the reportable conditions should be included in the report*.]

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the 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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might have reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe none of the reportable conditions described above is a material weakness. [*If conditions believed to be material weaknesses are disclosed, the last sentence should be deleted and instead the report should identify which of the reportable conditions described above are considered to be material weaknesses.*] [*If the CPA has issued a separate letter to management to communicate other matters involving the design and operation of the internal control over financial reporting, modify this paragraph to include a statement such as the following: We also noted other matters involving the internal control over financial reporting which we have reported to the management of Center County Electric Energy Association, Inc. in a separate letter dated March 2, 20X2*.]

This report is intended solely for the information and use of the audit committee, management, the Rural Utilities Service, and supplemental lenders and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Certified Public Accountants
March 2, 20X2

EXHIBIT 4 – SAMPLE FINANCIAL STATEMENTS

CENTER COUNTY ELECTRIC ENERGY ASSOCIATION
BALANCE SHEETS
DECEMBER 31, 20X1 and 20X0
ASSETS (Notes 1 and 2)

	20X1	20X0
Utility Plant (Note 3)		
Electric Plant in Service	$48,382,000	$46,826,000
Construction Work in Progress	2,040,000	1,586,000
Total Utility Plant	50,422,000	48,412,000
Accumulated Provision for Depreciation	15,588,000	14,586,000
Net Utility Plant	34,834,000	33,826,000
Investments (Note 4)		
Investments in Associated Organizations	4,493,000	4,048,000
Other	1,040,000	1,410,000
Total Investments	5,533,000	5,458,000
Current Assets		
Cash and Cash Equivalents	359,000	359,000
Short-Term Investments (Note 4)	8,000	8,000
Accounts Receivable, less allowance for doubtful accounts of $11,000 in 20X1 and $10,000 in 20X0	183,000	176,000
Materials and Supplies	418,000	404,000
Prepayments	43,000	43,000
Total Current Assets	1,011,000	990,000
Deferred Charges (Note 5)	28,000	9,000
Total Assets	$41,406,000	$40,283,000

The accompanying notes are an integral part of these statements.

CENTER COUNTY ELECTRIC ENERGY ASSOCIATION
BALANCE SHEETS
DECEMBER 31, 20X1 and 20X0
EQUITIES AND LIABILITIES (Note 1)

	20X1	20X0
Equities		
Memberships	$ 60,000	$ 59,000
Patronage Capital (Note 6)	16,683,000	15,343,000
Other Equities (Note 7)	268,000	180,000
Net Unrealized Gain on Investments (Note 4)	15,000	8,000
Total Equities	17,026,000	15,590,000
Long-term liabilities		
RUS Mortgage Notes, less current portion (Note 8)	16,956,000	17,532,000
CFC Mortgage Notes, less current portion (Note 8)	4,333,000	4,482,000
Post-retirement benefit obligation (Note 9)	1,004,000	841,000
Total Long-term liabilities	22,293,000	22,855,000
Current Liabilities		
Line of credit note payable	425,000	300,000
Current portion of long-term debt (Note 8)	725,000	700,000
Accounts Payable - Purchased Power	245,000	203,000
Accounts Payable – Other	109,000	91,000
Consumer Deposits	408,000	413,000
Other Current and Accrued Liabilities	116,000	78,000
Total Current Liabilities	2,028,000	1,785,000
Deferred Credits (Note 10)	59,000	53,000
Total Equities and Liabilities	$41,406,000	$40,283,000

The accompanying notes are an integral part of these statements.

CENTER COUNTY ELECTRIC ENERGY ASSOCIATION
STATEMENTS OF REVENUE AND PATRONAGE CAPITAL
FOR THE YEARS ENDED DECEMBER 31, 20X1 and 20X0

	20X1	20X0
Operating Revenues	$12,899,000	$12,042,000
Operating Expenses		
Cost of Power	4,408,000	4,095,000
Distribution Operations	833,000	913,000
Distribution Maintenance	1,553,000	1,236,000
Consumer Accounts	575,000	547,000
Consumer Service and Information	288,000	306,000
Administrative and General.....................................	710,000	653,000
Depreciation and Amortization................................	2,163,000	2,098,000
Other...	262,000	258,000
Total Operating Expenses	10,792,000	10,106,000
Operating Margins Before Interest Expense	$ 2,107,000	$ 1,936,000
Interest Expense	1,137,000	1,151,000
Operating Margins After Interest Expense.............	$ 970,000	$ 785,000
Nonoperating Margins		
Interest Income	50,000	30,000
Other Nonoperating Income	6,000	6,000
Total Nonoperating Margins.....................................	56,000	36,000
Generation and Transmission Cooperative Capital Credits	361,000	283,000
Net Margins..	$ 1,387,000	$ 1,104,000
Patronage Capital at Beginning of Year.................	15,343,000	14,345,000
Less: Retirements of Capital Credits	47,000	106,000
Patronage Capital at End of Year...........................	$16,683,000	$15,343,000

The accompanying notes are an integral part of these statements.

CENTER COUNTY ELECTRIC ENERGY ASSOCIATION
STATEMENTS OF COMPREHENSIVE INCOME
FOR THE YEARS ENDED DECEMBER 31, 20X1 and 20X0

	20X1	20X0
Net Margins...	$1,387,000	$1,104,000
Other Comprehensive Income		
Unrealized holding gains (losses) arising during the year..	7,000	8,000
Comprehensive Income..	$1,394,000	$1,112,000

The accompanying notes are an integral part of these statements.

CENTER COUNTY ELECTRIC ENERGY ASSOCIATION
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 20X1 and 20X0

	20X1	20X0
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash Received from Consumers	$12,882,000	$12,017,000
Cash Paid to Suppliers and Employees	(8,335,000)	(7,784,000)
Interest Received	50,000	30,000
Interest Paid	(1,137,000)	(1,151,000)
Net Cash Provided by Operating Activities	3,460,000	3,112,000
CASH FLOWS FROM INVESTING ACTIVITIES		
Construction and Acquisition of Plant	(2,010,000)	(3,285,000)
Plant Removal Costs	(1,378,000)	(270,000)
Materials Salvaged from Retirements	217,000	197,000
(Increase) Decrease In:		
Materials Inventory	(14,000)	10,000
Deferred Charges-Preliminary Surveys and Investigations	(19,000)	24,000
Investments in Associated Organizations	(76,000)	(56,000)
Other Investments	370,000	323,000
Inventory Adjustment-Deferred Credit Decrease	(12,000)	(5,000)
Net Cash Used in Investing Activities	(2,922,000)	(3,062,000)
CASH FLOWS FROM FINANCING ACTIVITIES		
Retirements of Patronage Capital Credits	(47,000)	(106,000)
Retired Capital Credits-Gain	6,000	6,000
Donated Capital	82,000	31,000
RUS Loan Advances	-	1,025,000
Payments on RUS Debt	(540,000)	(502,000)
Payments on CFC Debt	(160,000)	(149,000)
Line of Credit	125,000	(225,000)
Increase/(Decrease) In:		
Consumer Deposits	(5,000)	(1,000)
Memberships Issued	1,000	1,000
Net Cash Used in Financing Activities	(538,000)	80,000
Net Increase/(Decrease) in Cash	$ 0	$130,000
Cash - Beginning of Year	359,000	229,000
Cash - End of Year	$359,000	$359,000

The accompanying notes are an integral part of these statements.

RECONCILIATION OF NET MARGINS TO NET CASH PROVIDED BY OPERATING ACTIVITIES	20X1	20X0
Net Margins	$1,387,000	$1,104,000
Adjustments to Reconcile Net Margins to Net Cash		
Provided by Operating Activities:		
Depreciation and Amortization	2,163,000	2,098,000
G&T and Other Capital Credits (Non-Cash)	(362,000)	(283,000)
Provision for Uncollectible Accounts Receivable	1,000	(3,000)
Accumulated Provision for Pensions and Benefits	163,000	150,000
(Increase)/Decrease In:		
Customer and Other Accounts Receivable	(8,000)	13,000
Current and Accrued Assets – Other		1,000
Increase/(Decrease) In:		
Accounts Payable	60,000	26,000
Deferred Energy Prepayments	18,000	11,000
Current and Accrued Liabilities – Other	38,000	(5,000)
Total Adjustments	2,073,000	2,008,000
Net Cash Provided by Operating Activities	$3,460,000	$3,112,000

The accompanying notes are an integral part of these statements.

CENTER COUNTY ELECTRIC ENERGY ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 20X1 AND 20X0

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

[*Include a brief description of the reporting entity's significant accounting policies in accordance with Accounting Principles Board Opinion No. 22, Disclosure of Accounting Policies.*

Disclosure of accounting policies should identify and describe the accounting principles followed by the borrower and the methods of applying those principles that materially affect the determination of financial position, cash flow, and results of operations.

Disclosures of accounting policies do not have to be duplicated in this section if presented elsewhere as an integral part of the financial statements.]

2. ASSETS PLEDGED:

Substantially all assets are pledged as security for long-term debt to RUS and NRUCFC.

3. ELECTRIC PLANT AND DEPRECIATION RATES AND PROCEDURES:

Listed below are the major classes of the electric plant as of December 31, 20X1 and 20X0:

	20X1	20X0
Intangible Plant	$ 11,000	$ 11,000
Distribution Plant	45,753,000	44,370,000
General Plant	2,618,000	2,445,000
Electric Plant in Service	$48,382,000	$46,826,000
Construction Work in Progress	2,040,000	1,586,000
Total Utility Plant	$50,422,000	$48,412,000

Provision has been made for depreciation of distribution plant at a straight-line composite rate of 3.00 percent per annum. General Plant depreciation rates have been applied on a straight-line basis as follows:

Structures and Improvements	2.5%
Office Furniture and Equipment	10.0%
Transportation Equipment	14.0%
Power Operated Equipment	12.0%
Other General Plant	4.0%
Communications Equipment	6.0%

4. INVESTMENTS IN ASSOCIATED ORGANIZATIONS:

Investments in associated organizations consisted of the following at December 20X1 and 20X0:

	20X1	20X0
National Rural Utilities Cooperative Finance Corporation:		
Membership Fee	$ 1,000	$ 1,000
Capital Term Certificates	839,000	839,000
Patronage Capital	288,000	276,000
Fall River Power Cooperative	3,019,000	2,898,000
Other	346,000	34,000
	$ 4,493,000	$ 4,048,000

Center County Electric Association has adopted SFAS No. 115, “Accounting for Certain Investments in Debt and Equity Securities.” In accordance with SFAS No. 115, the Association has classified all the Other Investments as available-for-sale. Available-for-sale investments are stated at fair value with unrealized gains and losses included in members’ equities. The cost of investments sold is based on the specific identification method.

Long-term and short-term investments classified as available-for-sale were as follows at December 31, 20X1 and 20X0:

	20X1			
Description	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
U.S. Treasury notes, bills and bonds	$ 222,000	$14,000	$1,000	$ 235,000
Other U.S. Government agency securities	380,000	6,000	4,000	382,000
Other debt securities	431,000	3,000	3,000	431,000
	$1,033,000	$23,000	$8,000	$1,048,000

	20X0			
Description	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
U.S. Treasury notes, bills and bonds	$ 397,000	$5,000	$1,000	$ 401,000
Other U.S. Government agency securities	410,000	2,000		412,000
Other debt securities	604,000	1,000		605,000
	$1,411,000	$8,000	$1,000	$1,418,000

At December 31, 20X1, maturities of investments classified as available-for-sale were as follows:

	Amortized Cost	Fair Value
Less than One Year	$ 8,000	$ 8,000
One through Five Years	958,000	961,000
After Five Years	67,000	79,000
Total	$1,033,000	$1,048,000

5. DEFERRED CHARGES:

Following is a summary of amounts recorded as deferred charges as of December 31, 20X1 and 20X0:

	20X1	20X0
Preliminary Surveys and Investigations	$28,000	$ 9,000

6. PATRONAGE CAPITAL

At December 31, 20X1 and 20X0, patronage capital consisted of:

	20X1	20X0
Assignable	$ 1,387,000	$ 1,104,000
Assigned to date	15,955,000	14,851,000
	$17,342,000	$15,955,000
Less: Retirements to Date	659,000	612,000
	$16,683,000	$15,343,000

Under the provisions of the Mortgage Agreement, until the equities and margins equal or exceed thirty percent of the total assets of the cooperative, the return to patrons of contributed capital is generally limited to twenty-five percent of the patronage capital or margins received by the cooperative in the prior calendar year. The equities and margins of the cooperative represent 41 percent of the total assets at balance sheet date. Capital credit retirements in the amount of $47,000 were paid in 20X1.

7. OTHER EQUITIES:

At December 31, 20X1 and 20X0, other equities consisted of:

	20X1	20X0
Retired Capital Credits-Gain	$ 181,000	$ 175,000
Donated Capital	87,000	5,000
	$ 268,000	$ 180,000

8. MORTGAGE NOTES:

Long-term debt is primarily represented by mortgage notes payable to the United States of America and to the National Rural Utilities Cooperative Finance Corporation. Following is a summary of outstanding long-term debt as of December 31, 20X1 and 20X0:

	20X1	20X0
RUS, 2% Notes due March 31, 2007	$ 544,000	$ 562,000
RUS, 5% Notes due December 31, 2033	16,971,000	17,510,000
	$17,515,000	$18,072,000
Less: Current Maturities	559,000	540,000
	$16,956,000	$17,532,000

	20X1	20X0
CFC, 5.75% Notes due March 31, 2013	$ 166,000	$ 171,000
CFC, 6.95% Notes due July 31, 2018	1,453,000	1,499,000
CFC, 7.00% Notes due September 30, 2009	443,000	457,000
CFC, 6.40% Notes due October 31, 2026	2,437,000	2,515,000
	$4,499,000	$4,642,000
Less: Current Maturities	166,000	160,000
	$4,333,000	$4,482,000

Unadvanced loan funds of $286,000 and $2,500,000 are available to the cooperative on loan commitments from RUS and CFC as of December 31, 20X1. As of December 31, 20X1, annual maturities of long-term debt outstanding for the next five years are as follows:

	RUS	CFC	TOTAL
20X2	$559,000	$166,000	$725,000
20X3	563,000	167,000	730,000
20X4	565,000	167,000	732,000
20X5	568,000	168,000	736,000
20X6	570,000	169,000	739,000

9. EMPLOYEE BENEFITS:

Substantially all of the employees of the Association are covered by the ABC Retirement and Security Program, a defined benefit pension plan.

In addition to pension contributions the Association provides health care benefits for substantially all retired employees and dependents until they reach age 65.

The following illustrates the pension and postretirement benefits plans for the year ended December 31, 20X1 and 20X0.

	Pension Benefits		Other Benefits	
	20X1	20X0	20X1	20X0
Benefit obligation at December 31	$1,762,000	$2,080,000	$1,899,000	$1,800,000
Fair value of plan assets at December 31	715,000	513,000	0	0
Funded status	$(1,047,000)	$(1,567,000)	$(1,899,000)	$(1,800,000)
Prepaid (Accrued) benefit cost	$(243,000)	$(365,000)	$(1,004,000)	$(841,000)
Weighted-average assumptions as of December 31				
Discount rate	6.75%	5.50%	8.00%	8.00%
Expected return on plan assets	6.50%	6.00%		
Rate of compensation increase	5.00%	5.50%	6.00%	6.00%

For measurement purposes, a 10 percent annual rate of increase in the per capita cost of covered health benefits was assumed for 20X2. The rate was assumed to decrease gradually to 5 percent and remain at that level thereafter

	Pension Benefits		Other Benefits	
	20X1	20X0	20X1	20X0
Benefit cost	$253,000	$232,000	$220,000	$220,000
Employer Contribution	160,000	225,000	57,000	55,000
Benefits Paid	(7,000)	(48,000)	(57,000)	(55,000)

10. DEFERRED CREDITS:

Following is a summary of the amounts recorded as deferred credits as of December 31, 20X1 and 20X0:

	20X1	20X0
Customer Energy Prepayments	$ 33,000	$ 15,000
Inventory Adjustment	26,000	38,000
	$ 59,000	$ 53,000

11. LITIGATION:

The association is a defendant in an action in which the plaintiff claims damages totaling $200,000 for personal injuries sustained. The action has been dismissed by the District Court, but is on appeal before the State Supreme Court. Management is of the opinion that no liability will be incurred by the association as a result of this action.

12. COMMITMENTS:

Under its wholesale power agreement, the association is committed to purchase its electric power and energy requirements from Fall River Power Cooperative, Inc., until December 31, 20X7. The rates paid for such purchases are subject to review annually.

EXHIBIT 5 – ILLUSTRATIVE INDEPENDENT AUDITOR'S MANAGEMENT LETTER FOR ELECTRIC BORROWERS

RUS requires that CPAs auditing RUS borrowers provide a management letter in accordance with § 1773.33. This letter must be signed by the CPA, bear the same date as the auditor's report, and be addressed to the borrower's board of directors.

Illustrative Independent Auditors' Management Letter for Electric Borrowers

March 2, 20X2

Board of Directors
Center County Electric Energy Association, Inc.
[City, State]

We have audited the financial statements of Center County Electric Energy Association, Inc. for the year ended December 31, 20X1, and have issued our report thereon dated March 2, 20X2. We conducted our audit in accordance with generally accepted auditing standards, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and 7 CFR part 1773, Policy on Audits of Rural Utilities Service (RUS) Borrowers. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

In planning and performing our audit of the financial statements of Center County Electric Energy Association, Inc. for the year ended December 31, 20X1, we considered its internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the 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 material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the 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. We noted no matters involving the internal control over financial reporting that we consider to be material weaknesses. [*If a material weakness was noted, refer the reader to the independent auditors' report on compliance and on internal control over financial reporting*.]

Section 1773.33 requires comments on specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions, and other additional matters. We have grouped our comments accordingly. In addition to obtaining reasonable assurance about whether the financial statements are free from material misstatements, at your request, we performed tests of specific aspects of the internal control over financial reporting, of compliance with specific RUS loan and security instrument provisions, and of additional matters. The specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions, and additional matters tested include, among other things, the accounting procedures and records, materials control, compliance with specific RUS loan and security instrument provisions set forth in 7 CFR 1773.33 (e)(1), related party transactions, depreciation rates, a schedule of deferred debits and credits, and a schedule of investments, upon which we express an opinion. In addition, our audit of the financial statements also included the procedures specified in 7 CFR 1773.38 - .45. Our objective was not to provide an opinion on these specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions, or additional matters, and accordingly, we express no opinion thereon.

No reports other than our independent auditors' report, and our independent auditor’s report on compliance and on internal control over financial reporting, all dated March 2, 20X2 or summary of recommendations related to our audit have been furnished to management.

Our comments on specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions, and other additional matters as required by 7 CFR 1773.33 are presented below.

COMMENTS ON CERTAIN SPECIFIC ASPECTS OF THE INTERNAL CONTROL OVER FINANCIAL REPORTING

We noted no matters regarding Center County Electric Energy Association, Inc.'s internal control over financial reporting and its operation that we consider to be a material weakness as previously defined with respect to:

- The accounting procedures and records [*list other comments*];

- The process for accumulating and recording labor, material, and overhead costs, and the distribution of these costs to construction, retirement, and maintenance or other expense accounts [*list other comments*]; and

- The materials control [*list other comments*].

COMMENTS ON COMPLIANCE WITH SPECIFIC RUS LOAN AND SECURITY INSTRUMENT PROVISIONS

At your request, we have performed the procedures enumerated below with respect to compliance with certain provisions of laws, regulations, contracts, and grants. The procedures we performed are summarized as follows:

- Procedures performed with respect to the requirement for a borrower to obtain written approval of the mortgagee to enter into any contract for the operation or maintenance of property, or for the use of mortgaged property by others for the year ended December 31, 20X1:

1. Obtained and read a borrower-prepared schedule of new written contracts entered into during the year for the operation or maintenance of its property, or for the use of its property by others as defined in §1773.33 (e)(1)(i).

2. Reviewed Board of Director minutes to ascertain whether board-approved written contracts are included in the borrower-prepared schedule.

3. Noted the existence of written RUS [*and other mortgagee*] approval of each contract listed by the borrower.

- Procedure performed with respect to the requirement to submit RUS Form 7 or Form 12 to the RUS:

1. Agreed amounts reported in Form 7 or Form 12 to Center County Electric Energy Association, Inc.'s records.

The results of our tests indicate that, with respect to the items tested, Center County Electric Energy Association, Inc. complied, except as noted below, in all material respects, with the specific RUS loan and security instrument provisions referred to below. The specific provisions tested, as well as any exceptions noted, include the requirements that:

- The borrower has obtained written approval of the RUS [*and other mortgagees*] to enter into any contract for the operation or maintenance of property, or for the use of mortgaged property by others as defined in §1773.33 (e)(1)(i) [*list all exceptions*]; and

- The borrower has submitted its Form 7 or Form 12 to the RUS and the Form 7 or Form 12, Financial and Statistical Report, as of December 31, 20X1, represented by the borrower as having been submitted to RUS is in agreement with the Center County Electric Energy Association, Inc.'s audited records in all material respects [*list all exceptions*] [*or if the audit year end is other than December 31*], appears reasonable based upon the audit procedures performed [*list all exceptions*].

COMMENTS ON OTHER ADDITIONAL MATTERS

In connection with our audit of the financial statements of Center County Electric Energy Association, Inc., nothing came to our attention that caused us to believe that Center County Electric Energy Association, Inc. failed to comply with respect to:

- The reconciliation of continuing property records to the controlling general ledger plant accounts addressed at 7 CFR 1773.33 (c)(1) [*list all exceptions*];

- The clearing of the construction accounts and the accrual of depreciation on completed construction addressed at 7 CFR 1773.33 (c)(2) [*list all exceptions*];

- The retirement of plant addressed at 7 CFR 1773.33 (c)(3) and (4) [*list all exceptions*];

- Approval of the sale, lease or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap addressed at 7 CFR 1773.33 (c)(5) [*list all exceptions*];

- The disclosure of material related party transactions, in accordance with Statement of Financial Accounting Standards No. 57, Related Party Transactions, for the year ended December 31, 20X1, in the financial statements referenced in the first paragraph of this report addressed at 7 CFR 1773.33 (f) [*list all exceptions*];

- The depreciation rates addressed at 7 CFR 1773.33 (g) [*list all exceptions*];

- The detailed schedule of deferred debits and deferred credits; and

- The detailed schedule of investments.

Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The detailed schedule of deferred debits and deferred credits required by 7 CFR 1773.33 (h), and the detailed schedule of investments required by 7 CFR 1773.33 (i), and provided below, are presented for purposes of additional analysis and are not a required part of the basic financial statements. This information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

[*The detailed schedule of deferred debits and deferred credits would be included here. The total amount of deferred debits and deferred credits as reported in the schedule must agree with the totals reported on the Balance Sheet under the specific captions of "Deferred Debits" and "Deferred Credits". Those items that have been approved, in writing, by RUS should be clearly indicated*.]

[*The detailed schedule of investments would be included here. The total amount of the investment in each company reported in this schedule must agree with the detail investment subsidiary account(s)*.]

This report is intended solely for the information and use of the board of directors, management, and the RUS and supplemental lenders and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Certified Public Accountants

APPENDIX B

SAMPLE REPORTS FOR A CLASS A OR B COMMERCIAL TELECOMMUNICATIONS COMPANY

Appendix B includes an example of a short-form auditor's report, report on compliance and on internal controls over financial reporting, financial statements and accompanying notes, and management letter for a commercial telecommunications company. The sample auditor's report is intended as a guide only and, while it is recommended that the format be followed, each auditor's report should be prepared to adequately cover the circumstances. To the extent possible, it should be used as a guide in preparing auditors' reports for other types of telecommunications borrowers.

EXHIBIT 1 - SAMPLE AUDITOR'S REPORT

Certified Public Accountants
1600 Main Street
City, State 24105

The Board of Directors
Center County Telecommunications Systems Inc.

Independent Auditor's Report

We have audited the accompanying balance sheets of Center County Telecommunications Systems Inc. as of December 31, 20X1 and 20X0, and the related statements of revenue and patronage capital, and cash flows for the years then ended. These financial statements are the responsibility of Center County Telecommunications Systems, Inc.'s management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Center County Telecommunications Systems Inc. as of December 31, 20X1 and 20X0, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 2, 20X2, on our consideration of Center County Telecommunications Systems, Inc.'s internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Certified Public Accountants
March 2, 20X2

EXHIBIT 2
Sample Report on Compliance and on Internal Control over Financial Reporting, the CPA found No Reportable Instances of Noncompliance and No Material Weaknesses (No Reportable Conditions Identified)

Certified Public Accountants
1600 Main Street
City, State 24105

The Board of Directors
Center County Telecommunications Systems, Inc.

We have audited the financial statements of Center County Telecommunications Systems, Inc. as of and for the years ended December 31, 20X1 and 20X0, and have issued our report thereon dated March 2, 20X2. We conducted our audits in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether Center County Telecommunications Systems, Inc.'s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards.* [*If the CPA has issued a separate letter to the management detailing immaterial instances of noncompliance, modify this paragraph to include a statement such as the following: However, we noted certain immaterial instances of noncompliance which we have reported to the management of Center County Telecommunications Systems, Inc. in a separate letter dated March 2, 20X2*.]

Internal Control Over Financial Reporting

In planning and performing our audit we considered Center County Telecommunications Systems, Inc.'s internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the 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 material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the 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. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. [*If the CPA has issued a separate letter to management to communicate other matters involving the design and operation of the internal control over financial reporting, modify this paragraph to include a statement such as the following: However, we noted other matters involving the internal control over financial reporting which we have reported to the management of [Name of Company] in a separate letter dated March 2, 20X2.*]

This report is intended solely for the information and use of the audit committee, management, the Rural Utilities Service, and supplemental lenders, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Certified Public Accountants
March 2, 20X2

EXHIBIT 3

Sample Report on Compliance and on Internal Control over Financial Reporting, the CPA Found Reportable Instances of Noncompliance and Reportable Conditions were identified

Certified Public Accountants
1600 Main Street
City, State 24105

The Board of Directors
Center County Telecommunications Systems, Inc.:

We have audited the financial statements of Center County Telecommunications Systems, Inc. as of and for the years ended December 31, 20X1 and 20X0, and have issued our report thereon dated March 2, 20X2. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether Center County Telecommunications Systems, Inc.'s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards*. [*A description of the findings should be included in the report*.][*If the CPA has issued a separate letter to the management detailing immaterial instances of noncompliance, modify this paragraph to include a statement such as the following: We also noted certain immaterial instances of noncompliance which we have reported to the management of Center County Telecommunications Systems, Inc. in a separate letter dated March 2, 20X2*.]

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Center County Telecommunications Systems, Inc.'s internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect Center County Telecommunications

Systems, Inc.'s ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. [*A description of the reportable conditions should be included in the report*.]

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the 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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe none of the reportable conditions described above is a material weakness. [*If conditions believed to be material weaknesses are disclosed, the last sentence should be deleted and instead the report should identify which of the reportable conditions described above are considered to be material weaknesses*.] [*If the CPA has issued a separate letter to management to communicate other matters involving the design and operation of the internal control over financial reporting, modify this paragraph to include a statement such as the following: We also noted other matters involving the internal control over financial reporting which we have reported to the management of Center County Telecommunications Systems, Inc. in a separate letter dated March 2, 20X2*.]

This report is intended solely for the information and use of the audit committee, management, the Rural Utilities Service, and supplemental lenders and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Certified Public Accountants
March 2, 20X2

EXHIBIT 4 - SAMPLE FINANCIAL STATEMENTS

CENTER COUNTY TELECOMMUNICATIONS SYSTEMS, INC.
BALANCE SHEETS
DECEMBER 31, 20X1 and 20X0
ASSETS (Notes 1 and 2)

	20X1	20X0
Current Assets		
Cash - Construction Funds	$ 500	$ 300
Cash - General Funds	60,000	32,000
Temporary Investments	26,000	24,000
Accounts Receivable, less accumulated provision of $35,000 in 20X1 and $34,000 in 20X0.	740,000	667,000
Materials and Supplies	250,000	210,000
Prepayments (Note 3)	50,000	31,700
Other Current Assets	25,000	30,000
Total Current Assets	$1,151,500	$ 995,000
Noncurrent Assets		
Investments (Note 4)		
Marketable Securities	741,500	705,000
Nonregulated	1,550,000	1,450,000
Other deferred charges	39,000	12,000
Total Noncurrent Assets	2,330,500	2,167,000
Property, Plant and Equipment		
Telecommunications Plant in Service (Note 5)	22,800,000	20,100,000
Telecommunications Plant Under Construction	1,200,000	1,100,000
	24,000,000	21,200,000
Accumulated Provision for Depreciation	8,500,000	7,200,000
Total Property, Plant and Equipment	15,500,000	14,000,000
Total Assets	$18,982,000	$17,162,000

The accompanying notes are an integral part of these statements.

CENTER COUNTY TELECOMMUNICATIONS SYSTEMS, INC.
BALANCE SHEETS
DECEMBER 31, 20X1 and 20X0
LIABILITIES AND RETAINED EARNINGS(Note 2)

	20X1	20X0
Current Liabilities		
Accounts Payable	$320,000	$324,000
Customer Deposits	33,000	30,000
Current portion of long-term debt..........................	579,000	449,000
Accrued Taxes..	500	49,800
Other Current Liabilities	22,000	15,000
Total Current Liabilities	954,500	867,800
Long-term debt		
RUS Mortgage Notes, less current portion (Note 6)	8,900,000	8,100,000
Accrued Postretirement benefits (Note 7).............	664,000	503,000
Total Long-term liabilities.....................................	9,564,000	8,603,000
Other Liabilities and Deferred Credits		
Deferred Income Taxes (Note 8)	190,000	176,000
Other..	110,000	98,000
Total Other Liabilities and Deferred Credits..........	300,000	274,000
Stockholder's Equities		
Capital Stock - Common $100 par value-5,000 shares authorized; 3,500 outstanding 20X1 and 20X0	350,000	350,000
Additional Paid-in Capital......................................	250,000	250,000
Retained Earnings	7,560,500	6,814,800
Accumulated Other Comprehensive Income (Loss)	3,000	2,400
Total Stockholder's Equities.................................	8,163,500	7,417,200
Total Equities and Liabilities..................................	$18,982,000	$17,162,000

The accompanying notes are an integral part of these statements.

CENTER COUNTY TELECOMMUNICATIONS SYSTEMS, INC.
STATEMENTS OF INCOME AND RETAINED EARNINGS
FOR THE YEARS ENDED DECEMBER 31, 20X1 and 20X0

	20X1	20X0
Operating Revenues		
Local Network Services	$1,481,000	$924,000
Network Access Services	3,706,700	3,023,800
Billing and Collection Services	306,000	279,000
Miscellaneous	206,000	139,000
Less: Uncollectible Revenues	(26,000)	(22,000)
Total Operating Revenues	$5,673,700	$4,343,800
Operating Expenses		
Plant Specific Operations	976,000	676,000
Plant Nonspecific Operations	222,000	174,000
Depreciation and Amortization	1,341,000	855,000
Customer Operations	737,000	544,000
Corporate Operations	1,034,000	809,000
Other Taxes	26,000	36,000
Total Operating Expenses	4,336,000	3,094,000
Operating Income	$1,337,700	$1,249,800
Other Income (Expense)		
Interest and dividend income	238,000	236,000
Interest expense	(489,000)	(429,000)
Interest during construction	53,000	28,000
Net Other Income and Expenses	(198,000)	(165,000)
Income Before Income Taxes	$1,139,700	$1,084,800
Income Taxes	126,000	81,000
Net Income Before Nonregulated Income	$1,013,700	$1,003,800
Nonregulated Income	33,000	27,000
Net Income for the Period	$1,046,700	$1,030,800
Retained Earnings at Beginning of Year	6,814,800	6,053,000
Dividends Paid	301,000	269,000
Retained Earnings at End of Year	$7,560,500	$6,814,800

The accompanying notes are an integral part of these statements.

CENTER COUNTY TELECOMMUNICATIONS SYSTEMS, INC.
STATEMENTS OF COMPREHENSIVE INCOME
FOR THE YEARS ENDED DECEMBER 31, 20X1 and 20X0

	20X1	20X0
Net Income..	$1,046,700	$1,030,800
Other Comprehensive Income		
Unrealized holding gains (losses) arising during the year	600	1,500
Comprehensive Income...	$1,047,300	$1,032,300

The accompanying notes are an integral part of these statements.

CENTER COUNTY TELECOMMUNICATIONS SYSTEMS, INC.
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 20X1 and 20X0

	20X1	20X0
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash Received from Consumers	$5,382,000	$4,276,000
Cash Paid to Suppliers and Employees	(2,580,400)	(2,026,200)
Interest Received	238,000	236,000
Interest Paid	(489,000)	(429,000)
Taxes Paid	(141,500)	(94,000)
Net Cash Provided by Operating Activities	2,409,100	1,962,800
CASH FLOWS FROM INVESTING ACTIVITIES		
Construction and Acquisition of Plant	(2,612,000)	(2,523,000)
Plant Removal Costs	(229,000)	(82,000)
(Increase) Decrease In:		
Materials Inventory	(40,000)	(58,000)
Investments in Marketable Securities	(37,900)	(34,500)
Other Investments	(100,000)	(135,000)
Deferred Charges	(27,000)	23,000
Nonregulated Income	33,000	27,000
Net Cash Used in Investing Activities	(3,012,900)	(2,782,500)
CASH FLOWS FROM FINANCING ACTIVITIES		
Dividends Paid	(301,000)	(269,000)
Debt Proceeds	1,379,000	1,158,000
Payments on Long-Term Debt	(449,000)	(444,000)
Increase/(Decrease) In:		
Consumer Deposits and Advance Payments	3,000	13,000
Net Cash Provided by Financing Activities	632,000	458,000
Net Increase/(Decrease) in Cash	28,200	(361,700)
Cash - Beginning of Year	32,300	394,000
Cash - End of Year	60,500	32,300

The accompanying notes are an integral part of these statements.

RECONCILIATION OF NET MARGINS TO NET CASH PROVIDED BY OPERATING ACTIVITIES	20X1	20X0
Net Margins..	$1,046,700	$1,030,800
Less: Nonregulated Income................................	33,000	27,000
Net Income from Regulated Operations	1,013,700	1,003,800
Adjustments to Reconcile Net Margins to Net Cash Provided by Operating Activities:.............		
Depreciation and Amortization..........................	1,341,000	855,000
Provision for Uncollectible Accounts Receivable	1,000	1,000
Accumulated Provision for Pensions and Benefits..	161,000	133,000
(Increase)/Decrease In:		
Customer and Other Accounts Receivable........	(74,000)	(69,000)
Current and Accrued Assets – Other................	5,000	15,000
Prepayments..	(18,300)	15,000
Increase/(Decrease) In:		
Accounts Payable	(4,000)	29,000
Accrued Taxes..	(49,300)	(13,000)
Other Current and Accrued Liabilities................	7,000	(2,000)
Deferred Credits	26,000	(5,000)
Total Adjustments	1,395,400	959,000
Net Cash Provided by Operating Activities...........	$2,409,100	$1,962,800

The accompanying notes are an integral part of these statements.

CENTER COUNTY TELECOMMUNICATIONS SYSTEMS, INC.
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 20X1 AND 20X0

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Include a brief description of the reporting entity's significant accounting policies in accordance with Accounting Principles Board Opinion No. 22, Disclosure of Accounting Policies.

Disclosure of accounting policies should identify and describe the accounting principles followed by the borrower and the methods of applying those principles that materially affect the determination of financial position, cash flow, and results of operations.

Disclosures of accounting policies do not have to be duplicated in this section if presented elsewhere as an integral part of the financial statements.

2. ASSETS PLEDGED:

Substantially all assets are pledged as security for long-term debt to RUS.

3. PREPAID EXPENSES:

Following is a summary of the amounts recorded as prepaid items as of December 31, 20X1 and 20X0:

	20X1	20X0
Prepaid Taxes	$10,000	$10,000
Prepaid Insurance	3,000	1,700
Prepaid Rent	37,000	20,000
	$50,000	$31,700

4. INVESTMENTS:

MARKETABLE DEBT AND EQUITY SECURITIES:

Center County Telecommunications Systems, Inc., has adopted SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities." In accordance with SFAS No. 115, the company has classified all the Other Investments as available-for-sale. Available-for-sale investments are stated at fair value with unrealized gains and losses included in stockholder's equities. The cost of investments sold is based on the specific identification method.

The cost and fair values of marketable securities available-for-sale at December 31, 20X1 and 20X0 were:

Description	20X1 Amortized Cost	20X1 Gross Unrealized Gain	20X1 Gross Unrealized Loss	20X1 Fair Value
U.S. Government Treasury securities............	$ 62,500	$2,900	$900	$ 64,500
Certificate of Deposit	420,000			420,000
Debt Securities	280,000	6,000	3,000	283,000
	$762,500	$8,900	$3,900	$767,500

Description	20X0 Amortized Cost	20X0 Gross Unrealized Gain	20X0 Gross Unrealized Loss	20X0 Fair Value
U.S. Government Treasury securities............	$ 68,000	$1,200	$200	$ 69,000
Certificate of Deposit	408,000			408,000
Debt Securities	249,000	5,000	2,000	252,000
	$725,000	$6,200	$2,200	$729,000

At December 31, 20X1, maturities of investments classified as available-for-sale were as follows:

	Amortized Cost	Fair Value
Less than One Year...	$ 25,000	$ 26,000
One through Five Years...................................	681,000	684,000
After Five Years	56,500	57,500
Total...	$762,500	$767,500

As of December 31, 20X1 and 20X0, the amount of unrealized gains on available for sale securities included in accumulated other comprehensive income is shown net of deferred income taxes of $2,000 and $1,600, respectively.

NONREGULATED INVESTMENTS:

Investments in nonregulated activities consist of the following:

	20X1	20X0
Customer Premises Equipment	$ 493,000	$ 500,000
CATV equipment	650,000	678,000
Cellular facilities	1,329,000	1,047,000
Other	28,000	35,000
Total Nonregulated Investments	$2,500,000	$2,260,000
Less: Accumulated Depreciation	950,000	810,000
	$1,550,000	$1,450,000

Nonregulated property is stated at cost. The company provides for depreciation on a straight-line basis at annual rates which will amortize the depreciable property over its estimated useful life.

Following is a summary of net income from nonregulated investments for the year ending December 31, 20X1 and 20X0

	20X1	20X0
Income	$400,000	$268,000
Expenses	367,000	241,000
	$ 33,000	$ 27,000

Income tax expense related to these activities totaled $15,000 in 20X1 and $12,000 in 20X0.

5. INVESTMENT IN TELEPHONE PLANT:

Telephone Plant in Service and under construction is stated at cost. Listed below are the major classes of the telecommunications plant as of December 31, 20X1 and 20X0:

	20X1	20X0
Land	$ 185,000	$ 185,000
Buildings	1,385,000	1,435,000
Central Office Equipment	9,929,000	8,379,000
Outside Plant	10,226,000	9,120,000
Furniture and Office Equipment	352,000	256,000
Vehicles and Work Equipment	723,000	725,000
	$22,800,000	$20,100,000

The company provides for depreciation on a straight-line basis at annual rates which will amortize the depreciable property over its estimated useful life. Such provision, as a percentage of the average balance of telephone plant in service was 7.2 percent in 20X1 and 7.1 percent in 20X0.

6. MORTGAGE NOTES:

Long-term debt is represented by mortgage notes payable to the United States of America. Following is a summary of outstanding long-term debt as of December 31, 20X1 and 20X0:

	20X1	20X0
2% Notes due September 30, 20X8	$2,495,000	$2,373,000
5% Notes due March 31, 20X12	6,984,000	6,176,000
	$9,479,000	$8,549,000
Less: Current Maturities	579,000	449,000
	$8,900,000	$8,100,000

As of December 31, 20X1, there were no unadvanced funds.

Principal and interest installments on the above notes are due quarterly in equal amounts of $254,000. As of December 31, 20X1, annual maturities of long-term debt outstanding for the next five years are as follows:

20X2	$579,000
20X3	600,000
20X4	612,000
20X5	624,000
20X6	637,000

The long-term debt agreements contain restrictions on the payment of dividends or redemption of capital stock. The terms of the Mortgage Agreement require the maintenance of defined amounts in member's equity and working capital after payment of dividends.

7. EMPLOYEE BENEFITS:

Substantially all of the employees of the Company are covered by the ABC Retirement and Security Program, a multiemployer plan.

In addition to pension contributions the Company provides health care benefits for substantially all retired employees and dependents until they reach age 65.

The following illustrates the pension and postretirement benefits plans for the year ended December 31, 20X1 and 20X0.

	Pension Benefits		Other Benefits	
	20X1	20X0	20X1	20X0
Change in benefit obligation				
Benefit obligation beginning of year	$1,871,000	$1,841,000	$1,552,000	$1,464,000
Service Cost......................	115,000	145,000	39,000	39,000
Interest Cost	95,000	86,000	104,000	104,000
Actuarial Gain	(490,000)	(157,000)		
Benefits Paid.....................	(6,000)	(43,000)	(58,000)	(56,000)
Benefit obligation at end of year...............................	$1,585,000	$1,872,000	$1,637,000	$1,551,000

Change in plan assets

Fair value of plan assets beginning of year	$461,000	$281,000	$0	$0
Actual return on plan assets	45,000	21,000		
Employer Contribution	144,000	203,000	58,000	56,000
Benefits Paid.....................	(6,000)	(43,000)	(58,000)	(56,000)
Fair value of plan assets at end of year....................	$644,000	$462,000	$0	$0

Funded status	$(941,000)	$(1,410,000)	$(1,637,000)	$(1,551,000)
Unrecognized net actuarial loss(gain)............	(97,000)	428,000		
Unrecognized prior service cost.......................	627,000	654,000		
Unrecognized transition obligation			973,000	1,048,000
Prepaid (Accrued) benefit cost	$(411,000)	$(328,000)	$(664,000)	$(503,000)

Weighted-average assumptions as of December 31				
Discount rate.....................	6.75%	5.50%	8.00%	8.00%
Expected return on plan assets	6.50%	6.00%		
Rate of compensation increase	5.00%	5.50%	6.00%	6.00%

Components of net periodic benefit cost				
Service cost	$115,000	$145,000	$39,000	$39,000
Interest cost	95,000	86,000	104,000	104,000
Expected return on plan assets	(33,000)	(22,000)		
Amortization of prior service cost.......................	27,000	27,000		
Amortization of transition obligation			75,000	75,000
Recognized net actuarial loss	24,000	(28,000)		
Net periodic benefit cost ...	$228,000	$208,000	$218,000	$218,000

8. INCOME TAXES AND DEFERRED INCOME TAXES:

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amount of the company's assets and liabilities for financial reporting basis and the amounts used for income tax purposes.

Deferred federal and state tax assets and liabilities in the accompanying balance sheet include the following:

	December 31,	
	20X1	20X0
Deferred Tax Liabilities:		
Federal..	$192,000	$152,000
State	31,000	25,000

Total Deferred Tax Liabilities	223,000	177,000
Deferred Tax Assets		
Federal	28,000	700
State	5,000	300
Total Deferred Tax Assets	33,000	1,000
Net Deferred Tax Liability	$190,000	$176,000

Current Portion	$ 0	$ 0
Long-term portion	190,000	176,000
Net Deferred Tax Liability	$190,000	$176,000

Income taxes reflected in the Statement of Income and Retained Earnings include:

	December 31,	
	20X1	20X0
Federal income taxes:		
Current tax expense	$ 103,000	$ 71,000
Deferred tax expense	10,000	5,000
State income taxes:		
Current tax expense	12,000	6,000
Deferred tax expense	1,000	(1,000)
Total income tax expense	$ 126,000	$ 81,000

9. COMMITMENTS:

The company has executed contracts for construction programs for approximately $1,600,000 at December 31, 20X1. The amount unpaid against these commitments at December 31, 20X1 is $1,100,000.

EXHIBIT 5 - ILLUSTRATIVE INDEPENDENT AUDITOR'S MANAGEMENT LETTER FOR TELECOMMUNICATIONS BORROWERS

RUS requires that CPAs auditing RUS borrowers provide a management letter in accordance with §1773.33. This letter must be signed by the CPA, bear the same date as the auditor's report, and be addressed to the borrower's board of directors.

Illustrative Independent Auditors' Management Letter for
Telecommunications Borrowers

March 2, 20X2

Board of Directors
Center County Telecommunications Systems, Inc.
[City, State]

We have audited the financial statements of Center County Telecommunications Systems, Inc. for the year ended December 31, 20X1, and have issued our report thereon dated March 2, 20X2. We conducted our audit in accordance with generally accepted auditing standards, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and 7 CFR part 1773, Policy on Audits of Rural Utilities Service (RUS) Borrowers. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

In planning and performing our audit of the financial statements of Center County Telecommunications Systems, Inc. for the year ended December 31, 20X1, we considered its internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the 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 material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the 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. We noted no matters involving the internal control over financial reporting that we consider to be material weaknesses. [*If a material weakness was noted, refer the reader to the independent auditors' report on compliance and on internal control over financial reporting*.]

Section 1773.33 requires comments on specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions, and other additional matters. We have grouped our comments accordingly. In addition to obtaining reasonable assurance about whether the financial statements are free from material misstatements, at your request, we performed tests of specific aspects of the internal control over financial reporting, of compliance with specific RUS loan and security instrument provisions, and of additional matters. The specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions, and additional matters tested include, among other things, the accounting procedures and records, materials control, compliance with specific RUS loan and security instrument provisions set forth in 7 CFR 1773.33 (e)(2), and related party transactions and investments. In addition, our audit of the financial statements also included the procedures specified in 7 CFR 1773.38 - .45. Our objective was not to provide an opinion on these specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions, or additional matters, and accordingly, we express no opinion thereon.

No reports other than our independent auditors' report, and our independent auditor's report on compliance and on internal control over financial reporting, all dated March 2, 20X2 or summary of recommendations related to our audit have been furnished to management.

Our comments on specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions, and other additional matters as required by 7 CFR 1773.33 are presented below.

COMMENTS ON CERTAIN SPECIFIC ASPECTS OF THE INTERNAL CONTROL OVER FINANCIAL REPORTING

We noted no matters regarding Center County Telecommunications Systems, Inc.'s internal control over financial reporting and its operation that we consider to be a material weakness as previously defined with respect to:

- The accounting procedures and records [*list other comments*];

- The process for accumulating and recording labor, material, and overhead costs, and the distribution of these costs to construction, retirement, and maintenance or other expense accounts [*list other comments*]; and

- The materials control [*List other comments*].

COMMENTS ON COMPLIANCE WITH SPECIFIC RUS LOAN AND SECURITY INSTRUMENT PROVISIONS

At your request, we have performed the procedures enumerated below with respect to compliance with certain provisions of laws, regulations, contracts, and grants. The procedures we performed are summarized as follows:

- Procedures performed with respect to the requirement for a borrower to obtain written approval of the mortgagee to enter into any contract, agreement or lease between the borrower and an affiliate of Center County Telecommunications Systems, Inc. for the year ended December 31, 20X1:

1. Obtained and read a borrower-prepared schedule of new written contracts, agreements or leases entered into during the year between the borrower and an affiliate as defined in §1773.33 (e)(2)(i).

2. Reviewed Board of Director minutes to ascertain whether board-approved written contracts are included in the borrower-prepared schedule.

3. Noted the existence of written RUS [*and other mortgagee*] approval of each contract listed by the borrower.

- Procedure performed with respect to the requirement to submit RUS Form 479 to the RUS:

1. Agreed amounts reported in Form 479 to Center County Telecommunications Systems, Inc.'s records.

The results of our tests indicate that, with respect to the items tested, Center County Telecommunications Systems, Inc. complied, except as noted below, in all material respects, with the specific RUS loan and security instrument provisions referred to below. The specific provisions tested, as well as any exceptions noted, include the requirements that:

- The borrower has obtained written approval of the RUS [*and other mortgagees*] to enter into any contract, agreement or lease with an affiliate as defined in §1773.33 (e)(2)(i) [*list all exceptions*]; and

- The borrower has submitted its Form 479 to the RUS and the Form 479, Financial and Statistical Report, as of December 31, 20X1, represented by the borrower as having been submitted to RUS is in agreement with the Center County Telecommunications Systems, Inc.'s audited records in all material respects [*list all exceptions*] [*or if the audit year end is other than December 31*], appears reasonable based upon the audit procedures performed [*list all exceptions*].

COMMENTS ON OTHER ADDITIONAL MATTERS

In connection with our audit of the financial statements of Center County Telecommunications Systems, Inc., nothing came to our attention that caused us to believe that Center County Telecommunications Systems, Inc. failed to comply with respect to:

- The reconciliation of continuing property records to the controlling general ledger plant accounts addressed at 7 CFR 1773.33 (c)(1) [*list all exceptions*];

- The clearing of the construction accounts and the accrual of depreciation on completed construction addressed at 7 CFR 1773.33 (c)(2) [*list all exceptions*];

- The retirement of plant addressed at 7 CFR 1773.33 (c)(3) and (4) [*list all exceptions*];

- The approval of the sale, lease or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap addressed at 7 CFR 1773.33 (c)(5) [*list all exceptions*];

- The disclosure of material related party transactions, in accordance with Statement of Financial Accounting Standards No. 57, Related Party Transactions, for the year ended December 31, 20X1, in the financial statements referenced in the first paragraph of this report addressed at 7 CFR 1773.33 (e) [*list all exceptions*]; and

- The detailed schedule of investments.

Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The detailed schedule of investments required by 7 CFR 1773.33 (i), and provided below, is presented for purposes of additional analysis and is not a required part of the basic financial statements. This information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

[*The detailed schedule of investments would be included here. The total of the investment in each company reported in this schedule must agree with the detail investment subsidiary account(s)*.]

This report is intended solely for the information and use of the board of directors, management, and the RUS and supplemental lenders and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Certified Public Accountants