USDA

U.S. Department of Agriculture

Office of Inspector General
Financial & IT Operations

Audit Report

Rural Development's Financial Statements for Fiscal Years 2008 and 2007

Report No. 85401-15-FM
November 2008

UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250

November 7, 2008

REPLY TO
ATTN OF: 85401-15-FM

TO: Thomas C. Dorr
Under Secretary
for Rural Development

ATTN: John M. Purcell
Director
Financial Management Division

FROM: Robert W. Young /s/
Assistant Inspector General
for Audit

SUBJECT: Rural Development's Financial Statements for Fiscal Years 2008 and 2007

This report presents the results of our audits of Rural Development's financial statements for the fiscal years ending September 30, 2008, and 2007. The report contains a qualified opinion for fiscal year 2007 and an unqualified opinion for fiscal year 2008, as well as the results of our assessment of Rural Development's internal control over financial reporting and compliance with laws and regulations. Your response to the draft report, dated November 6, 2008 is included in its entirety in exhibit B.

Based on the agency response provided and included in this report, we reached management decision on all recommendations included in the report. Please follow your agency's internal procedures in forwarding documentation for final action to the Office of the Chief Financial Officer.

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

Executive Summary

Rural Development's Financial Statements for Fiscal Years 2008 and 2007 (Audit Report No. 85401-15-FM)

Purpose

Our audit objectives were to determine whether (1) the financial statements present fairly, in all material respects, in accordance with generally accepted accounting principles, the assets, liabilities, and net position, net costs, changes in net position, and budgetary resources; (2) the internal control objectives over financial reporting were met; and (3) Rural Development complied with laws and regulations for those transactions and events that could have a direct and material effect on the financial statements. We also determined that the information in the Management Discussion and Analysis was materially consistent with the information in the financial statements.

We conducted our audits at the Rural Development finance office and Centralized Servicing Center in St. Louis, Missouri, and the Rural Development national office in Washington, D.C.

Results in Brief

In our opinion the consolidated financial statements for fiscal year 2008, including the accompanying notes, present fairly, in all material respects, the financial position of Rural Development as of September 30, 2008; and its net costs, changes in net position, and budgetary resources for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

For fiscal year 2007, we issued a qualified opinion on Rural Development's consolidated balance sheet, and its related consolidated statements of net cost; and changes in net position due to our inability to obtain sufficient, appropriate evidence to support Rural Development's financial statement amounts related to its credit reform processes.

In fiscal year 2008, Rural Development addressed previously reported weaknesses in the credit reform area. Considerable efforts were made by the agency to ensure adequate quality control was maintained over the credit reform processes. As a result of these efforts, Rural Development's material weakness was downgraded to a significant deficiency as noted in our report on the Internal Control over Financial Reporting. Based on our review of the three direct loan models for Single Family Housing, Non-Housing, and Electric Underwriter, we identified and reported that Rural Development needs to make further improvements.

Our report on compliance with laws and regulations did not disclose any instances of noncompliance.

Key Recommendations

We recommended that Rural Development document, explain, and provide support for any adjustments made to the cumulative cash difference and continue to make enhancements to the direct cash flow models in fiscal year 2009 and implement those changes early in the fiscal year. This will allow for more time to ensure that all changes to the models are properly made and reviewed.

Agency Response. Rural Development agreed with the significant deficiency and the recommendations. Rural Development's response discussed a plan of action to address the findings and recommendations identified during the audit. The plan included the specific actions to be taken on the recommendations and their estimated completion dates. Rural Development's response is included as exhibit B.

OIG Position. Based on Rural Development's response to this audit, we were able to reach management decision on both recommendations contained in the report.

Abbreviations Used in This Report

FFMIA	Federal Financial Management Improvement Act of 1996
FMFIA	Federal Managers' Financial Integrity Act of 1982
OCFO	Office of the Chief Financial Officer
OIG	Office of Inspector General
OMB	Office of Management and Budget
RUS	Rural Utilities Service
SFH	Single Family Housing

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UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250

Report of the Office of Inspector General

To: Thomas C. Dorr
Under Secretary
for Rural Development

We have audited the accompanying consolidated balance sheets of Rural Development as of September 30, 2008, and 2007, and the related consolidated statements of net cost; and changes in net position; and the combined statements of budgetary resources (hereinafter referred to as the "consolidated financial statements") for the fiscal years then ended. The consolidated financial statements are the responsibility of Rural Development's management. Our responsibility is to express an opinion on the consolidated financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and the Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audit to obtain reasonable assurance that the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion the consolidated financial statements present fairly, in all material respects, the financial position of Rural Development as of September 30, 2008; and its net costs, and changes in net position, and budgetary resources for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

For fiscal year 2007, we issued a qualified opinion on Rural Development's consolidated balance sheet, and its related consolidated statements of net cost; and changes in net position due to our inability to obtain sufficient, appropriate evidence to support Rural Development's financial statement amounts related to its credit reform processes.

The information in Management's Discussion and Analysis and Required Supplementary Information is not a required part of the consolidated financial statements, but is supplemental information required by accounting principles generally accepted in the United States of America and OMB Circular No. A-136. We have applied certain limited procedures, consisting principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information and, accordingly, we express no opinion on it.

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

Rural Development’s response to the findings identified in our audit is presented in exhibit B. We did not audit the response and, accordingly, we express no opinion on it.

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

Robert W. Young /s/
Assistant Inspector General
for Audit

November 7, 2008

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

To: Thomas C. Dorr
Under Secretary
for Rural Development

We have audited the accompanying consolidated balance sheets of Rural Development as of September 30, 2008, and 2007, and the related consolidated statements of net cost; and changes in net position; and the combined statements of budgetary resources (hereinafter referred to as the "consolidated financial statements") for the fiscal years then ended, and have issued our report thereon, dated November 7, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and the Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended.

In planning and performing our audit, we considered Rural Development's internal control over financial reporting by obtaining an understanding of the design effectiveness of internal controls, determining whether the internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in *Government Auditing Standards* and OMB Bulletin No. 07-04. We did not test all internal controls as defined by the Federal Managers' Financial Integrity Act (FMFIA) of 1982. The objective of our audits was not to provide assurance on Rural Development's internal control. Consequently, we do not provide an opinion on internal control over financial reporting.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be significant deficiencies. Under standards issued by the American Institute of Certified Public Accountants, significant deficiencies are deficiencies in internal control, or a combination of deficiencies, that adversely affects Rural Development's ability to initiate, authorize, record, process, or report financial data reliably and in accordance with accounting principles generally accepted in the United States of America such that there is more than a remote likelihood that a misstatement of the financial statements being audited that is more than inconsequential will not be prevented or detected. Material weaknesses are significant deficiencies or a combination of significant deficiencies that result in more than a remote likelihood that material misstatements in relation to the financial statements being audited will not be prevented or detected. Because of inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected. We noted certain matters described in the Findings and Recommendations, Section 1, involving the internal control over financial reporting and its operation that we consider to be significant deficiencies. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Additional Other Procedures

As required by OMB Bulletin No. 07-04, we considered Rural Development's internal control over Required Supplemental Information by obtaining an understanding of the internal control, determining whether these internal controls had been placed in operation, assessing control risk, and performing tests of controls. Our procedures were not designed to provide assurance on internal control over such Required Supplemental Information; accordingly, we do not provide an opinion on such controls.

We did not identify any material weaknesses that were not disclosed in Rural Development's FMFIA report.

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

Robert W. Young /s/
Assistant Inspector General
for Audit

November 7, 2008

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

To: Thomas C. Dorr
Under Secretary
for Rural Development

We have audited the consolidated balance sheets of Rural Development as of September 30, 2008, and 2007, and the related consolidated statements of net cost; changes in net position; and the combined statement of budgetary resources (hereinafter referred to as the "consolidated financial statements") for the fiscal years then ended, and have issued our report thereon, dated November 7, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and the Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended.

The management of Rural Development is responsible for complying with laws and regulations applicable to it. As part of obtaining reasonable assurance about whether the consolidated financial statements are free of material misstatement, we performed tests of Rural Development's compliance with certain provisions of laws, regulations, contracts and agreements, and Governmentwide policy requirements, noncompliance with which could have a direct and material effect on the determination of the consolidated financial statement amounts. We also obtained reasonable assurance that Rural Development complied with certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04, including requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996, except for those that, in our judgment, were clearly inconsequential. We noted no reportable instances of noncompliance with these laws and regulations. We limited our tests of compliance to the provisions described in the preceding sentence and did not test compliance with all laws and regulations applicable to Rural Development. However, providing an opinion on compliance with laws and regulations was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests and information brought to our attention during our audit disclosed no instances of reportable noncompliance or other matters that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 07-04. Additionally, the results of our tests disclosed no instances in which Rural Development's financial management systems did not substantially comply with FFMIA.

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

Robert W. Young /s/
Assistant Inspector General
for Audit

November 7, 2008

Significant deficiencies are matters coming to our attention that, in our judgment, should be communicated because they represent deficiencies that adversely affect the organization's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the consolidated financial statements that is more than inconsequential will not be prevented or detected prior to being certified as valid.

Finding 1 Credit Reform Processes Can Be Strengthened

Overall, Rural Development significantly improved its credit reform processes during fiscal year 2008. Considerable efforts were made to ensure adequate quality control was maintained over the processes. Those efforts resulted in deliverables that underwent quality control prior to the Office of Inspector General's (OIG) review and generally provided timely and adequate support for the credit reform reestimates for fiscal year 2008.

Based on our review we identified opportunities for further improvements to the following direct models: Single Family Housing (SFH), non-housing, and electric underwriter.

<u>SFH Model</u>

In fiscal year 2008, Rural Development hired a contractor to perform a review of the direct SFH model. Based on recommendations made from that review, as well as OIG's concerns, Rural Development made further changes to the direct SFH model. There are several remaining concerns as described below.

- The direct SFH balancing amounts and its relation to data on past prepayments and defaults caused net loans receivable to be overestimated by approximately $165 million.

- The methodology used to calculate the reamortization and fee rates needs to be improved by implementing a curve for the rates rather than utilizing a single point estimate.

- Prepayment and recapture curves need to be reviewed and adjusted accordingly to ensure stability across all cohorts.

- Cumulative cash differences for the direct housing programs need to be reconciled in accordance with Office of Management and Budget (OMB) Circular No. A-11.

Non-housing Model

A new direct non-housing model was implemented in fiscal year 2008. We identified model and/or data improvements needed in the following areas.

- An independent validation and verification were performed for the model. However, the documentation for this review did not provide adequate information to determine the depth of the review.

- The non-housing model was too large for the OMB Credit Subsidy Calculator 2 tool to handle. A work around had been developed and a data automation tool implemented to reduce the risk of manual manipulation. The automation tool was not provided to OIG until mid-September 2008. The tool became an integral part of the reestimate process. As such, it should be subject to documented user and acceptance testing.

- Input curves require further analysis.

- Data anomalies need to be researched and corrected if necessary rather than relying on the unpaid principal balance reconciliation to mitigate their impact.

- Erroneous cell references and missing entries for capitalized interest require correction.

Electric Underwriter Model

The electric underwriter model had data errors that resulted in inaccurate reestimates for fiscal year 2008. Based on OIG's comments, Rural Development corrected the errors and reran the fiscal year 2008 reestimates.

In accordance with Federal Accounting Standards Advisory Board Technical Release No. 6, Preparing Estimates for Direct Loan and Loan Guarantee Subsidies, dated January 2004, paragraph 36 provides that changes in key factors and assumptions used as a baseline (e.g., disbursement rates, default rates, recovery rates, time periods, etc.) must be explained, supported, and documented. Paragraph 40 states the cash flow estimation process, including all underlying assumptions, should be reviewed and approved at the appropriate level including revisions and updates to the original model. Cash flow models should be tested for reliability as part of the approval process by comparing estimated cash flows to actual cash flows and assessing the model's ability to replicate a credit program's performance.

Recommendation 1

Document, explain, and provide support for any adjustments made to the cumulative cash difference.

Agency Response. Rural Development concurs with this recommendation. It agreed to provide documentation and audit support for any adjustments to the cumulative cash differences for the single family housing programs. The support will be provided for cumulative differences and adjustments with the June 30, 2009 business close.

OIG Position. We concur with the management decision.

Recommendation 2

Continue to make enhancements to the three direct cash flow models in fiscal year 2009 and implement those changes early in the fiscal year. This will allow more time to ensure that all changes to the models are properly made and reviewed.

Agency Response. Rural Development concurs with this recommendation. It will implement agreed upon changes to Models A and B, test the changes, and provide the updated models to OIG by March 31, 2009. Rural Development will also determine the feasibility of incorporating the Underwriters Program (Model 313A) into Model B by the same date. With regard to new Model D, Rural Development plans to deliver the populated and validated model by May 1, 2009.

OIG Position. We concur with the management decision.

STATUS OF PRIOR YEAR RECOMMENDATIONS

Audit No. 85401-13-FM[1]

NUMBER	RECOMMENDATION	AGENCY RESPONSE	STATUS
1	Ensure that cash flow models, data inputs, estimates, reestimates, and related financial reporting are subject to appropriate controls, including management oversight review.	Rural Development planned the following corrective actions: • Perform reconciliations of the obligations and disbursements included in the housing cash flow models to the Status of Allotment Ledger Accounts report, document and explain any differences. • Expand the checklist for reviewing the 313A model data and reestimates. This will include verifying the distinction between annual and semiannual dollar amounts is maintained; the estimated interest rates for reestimates are replaced with actual interest rates for all years with actual rates that are known; and the principal repayments are scheduled for the correct years. • Perform documented second party reviews and notate differences for quality control packages and data extracts.	Open. Rural Development achieved Management Decision on December 15, 2006. For final action, Rural Development should provide the Office of the Chief Financial Officer (OCFO) with copies of the housing reconciliations, the expanded 313A checklist, and the second party reviews performed at yearend.

[1] Recommendations were made in Audit Report No. 85401-13-FM, *Rural Development's Financial Statements for Fiscal Years 2006 and 2005,* issued November 2006.

NUMBER	RECOMMENDATION	AGENCY RESPONSE	STATUS
2	Ensure borrowers are contacted sufficiently in advance of the certification process to obtain timely responses.	Rural Development agreed to send letters to all borrowers with loans that are more than 5 years old that have unadvanced balances. Letters would be sent by March 31st each fiscal year. Rural Development recognized it must take additional steps to certify the need for unliquidated obligations that are more than 3 years old, but have not reached the 5 year time frame that requires a letter. Therefore, Rural Development planned to have the general field representatives periodically visit all borrowers with unadvanced funds and discuss the continuing need for the loan funds.	Closed. Rural Development achieved Management Decision on December 15, 2006. For final action, Rural Development provided OCFO with the list of borrowers sent letters and those visited by the general field representatives. OCFO accepted final action on July 22, 2008.
3	Ensure all Telecommunications unliquidated obligations included in the certification reports are adequately supported prior to certification.	Telecommunications personnel agreed to maintain all correspondence regarding deobligations. This support would be used in making their periodic certifications by May 31, 2007.	Closed. Rural Development achieved Management Decision on December 15, 2006. For final action, Rural Development provided OCFO verification that adequate support documentation was maintained for the unliquidated obligation process. OCFO accepted final action on July 22, 2008.

Exhibit A – Status of Prior Year Recommendations

NUMBER	RECOMMENDATION	AGENCY RESPONSE	STATUS
4	Ensure all records identified by borrowers for rescission are deobligated and properly recorded prior to fiscal yearend.	The loan documents for the “Traditional” Loan Program and the Broadband Loan Program now contain requirements that 5 years after the date of the note any unadvanced funds would be rescinded. These documents were being used with each new loan. Rural Utilities Service (RUS) was required to depend on borrowers with older loans to request rescissions. The Telecommunications Program, however, strived to obtain such requests when funds are no longer necessary to accomplish the purposes of a particular loan. RUS agreed to deobligate, within the limits of the law, those funds that are no longer needed by its borrowers. As rescissions were requested, or allowed through mutual agreement, Rural Development would deobligate loans funds no longer needed by borrowers. Normally, such deobligations would be approved and properly recorded prior to fiscal yearend. However, due to time and other constraints, rescissions requested near the end of the fiscal year may not be finalized until the following fiscal year.	Closed. Rural Development achieved Management Decision on December 15, 2006. For final action, Rural Development provided OCFO with the list of borrowers with deobligations for fiscal year 2007. OCFO accepted final action on January 17, 2008.

NUMBER	RECOMMENDATION	AGENCY RESPONSE	STATUS
5	Develop a checklist for each program to ensure all procedures outlined in the methodology are performed. This should include the verification of formulas in key computed fields.	For fiscal year 2007 financial statements, Rural Development would develop a checklist for the liquidating allowance procedures and verify related formulas.	Closed. Rural Development achieved Management Decision on March 1, 2007. For final action, Rural Development provided OCFO with a copy of the checklist for the liquidating allowance procedures. OCFO accepted final action on July 10, 2007.
6	Ensure a documented second party review is performed for each program.	Rural Development agreed to perform a documented second party review for the fiscal year 2007 financial statements liquidating methodology and subsidy allowance calculations. This second party review would be accomplished prior to the delivery of the financial statements package to the Office of Inspector General (OIG).	Closed. Rural Development achieved Management Decision on March 1, 2007. For final action, Rural Development provided OCFO with the second party reviews performed for fiscal year 2007. OCFO accepted final action on February 6, 2008.

Audit No. 85401-14-FM[2]

NUMBER	RECOMMENDATION	AGENCY RESPONSE	STATUS
1	Ensure that all new cash flow design models are adequately documented and that quality control reviews are performed by the agency in time to provide for audit.	The Budget Division was implementing a multifaceted approach to strengthening the credit reform process in 2008. The Division planned to augment staffing in the Credit Reform Branch. In addition, the Division contracted for development of credit reform policies and procedures and independent testing of newly developed credit models.	Open. Rural Development achieved Management Decision on February 14, 2008. For final action, Rural Development should provide OCFO with the results of the independent validation and verification performed on all new models. Budget Division should also provide OCFO with the staffing updates and all credit reform policies and procedures.

[2] Recommendations were made in Audit Report No. 85401-14-FM, *Rural Development's Financial Statements for Fiscal Years 2007 and 2006*, issued November 2007.

NUMBER	RECOMMENDATION	AGENCY RESPONSE	STATUS
2	Document and explain any differences identified and provide support for the second party reviews performed.	Rural Development agreed to perform the timely reconciliation of the pivot tables including the key words for all models as of September 30, 2007. The reconciliation and support for second party reviews would be provided to OIG by March 31, 2008. For future years, Rural Development would develop a plan by June 30, to ensure the reconciliations are performed timely.	Open. Rural Development achieved Management Decision on February 14, 2008. For final action, Rural Development should provide OCFO and OIG with the pivot table reconciliations performed as of September 30, 2007, and OCFO with the OIG agreed-upon plan for the reconciliations for future years.
3	Review data input to the reestimate process for accuracy and completeness. This should include documentation of a second party review.	Rural Development met with OIG in January 2008 requested specific areas of concern to be identified. Based on the results of their audit documentation reviewed and suggestions, Rural Development would develop new credit reform checklists and procedures and provide to OIG by June 30, 2008, with full implementation and submission of checklist deliverables to OIG for their review during October 2008.	Open. Rural Development achieved Management Decision on March 3, 2008. For final action, Rural Development should provide OCFO with any new or revised checklists and procedures for the reestimate process, as well as the completed checklists for fiscal yearend.

Exhibit B – Agency Response

USDA Rural Development

United States Department of Agriculture
Rural Development
Office of the Under Secretary

NOV 0 6 2008

TO: Wanda Philippi
Regional Inspector General
Financial and IT Operations Division
Office of the Inspector General
8930 Ward Parkway, Suite 3016
Kansas City, Missouri 64114

FROM: Thomas C. Dorr
Under Secretary

OCT 2 0 2008

SUBJECT: Response to Draft Audit Report on Rural Development's Fiscal Year 2008 Consolidated Financial Statements

We have reviewed the Office of Inspector General Draft Report on the Rural Development fiscal year 2008 consolidated financial statements, Report on Internal Control Structure Over Financial Reporting, and the Report on Compliance with Laws and Regulations and agree on their contents.

Rural Development will develop a plan of action to address the findings and recommendations identified during the audit. The plan will include the specific actions to be taken on the recommendations and their estimated completion date.

I would like to thank your office for its continuing professionalism in conducting the audit.

Committed to the future of rural communities.

"USDA is an equal opportunity provider, employer and lender."
To file a complaint of discrimination write USDA, Director, Office of Civil Rights, 1400 Independence Avenue, S.W., Washington, DC 20250-9410 or call (800)795-3272 (voice) or (202) 720-6382 (TDD).

Rural Development Response to Audit 85401-15-FM

Recommendation 1

Document, explain, and provide support for any adjustments made to the cumulative cash difference

Agency Response:

Rural Development agrees to provide documentation and audit support for any adjustments to the cumulative cash differences for the single family housing programs. The support will be provided for cumulative differences and adjustments with the June 30, 2009 business close.

Recommendation 2

Continue to make enhancements to the three direct cash flow models in fiscal year 2009 and implement those changes early in the fiscal year. This will allow more time to ensure that all changes to the models are properly made and reviewed.

Agency Response:

Rural Development will implement agreed upon changes to Models A and B, test the changes, and provide the updated models to the Office of Inspector General by March 31, 2009. Rural Development will also determine the feasibility of incorporating the Underwriters Program (Model 313A) into Model B by the same date. With regard to new Model D, Rural Developments plans to deliver the populated and validated model by May 1, 2009.

11-06-08

Exhibit C – Consolidated Financial Statements

USDA
RURAL DEVELOPMENT

FISCAL YEARS 2008 and 2007

(PREPARED BY RURAL DEVELOPMENT)

USDA Rural Development

Committed to the future of rural communities.

Consolidated Financial Statements

Fiscal Year 2008 and 2007

USDA Rural Development

Committed to the future of rural communities.

Consolidated Financial Statements

Fiscal Year 2008 and 2007

Rural Development

Management Discussion and Analysis (Unaudited)

Rural Development’s vision for rural America

Mission Statement

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

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

As a venture capital entity, Rural Development invests in rural America to provide equity and technical assistance to finance and foster growth in homeownership, business developments, and critical community and technology infrastructures. Rural Development serves as a catalyst to improve conditions in rural America by offering financial and technical assistance needed to improve the quality of life in rural America, increasing the flow of capital through leveraged partnerships, and to help individuals and businesses compete in the global marketplace. These programs consist of a variety of loan, loan guarantee, and grant programs, plus technical assistance in the areas of business development; cooperative development; rural housing; community facilities; water and environment; electric power; and telecommunications, including distance learning and telemedicine.

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

Key Goals

Two key Rural Development goals are:

Goal 1. Increase Economic Opportunity in Rural America. Rural Development will increase economic development in rural America by strengthening rural technology infrastructures, providing communities with access to broadband service that allows participation in the developing global economy, providing access to capital and credit for development, encouraging growth and establishment of rural businesses, and promoting energy independence.

Goal 2. Improve the Quality of Life in Rural America. Rural Development will improve the quality of life in rural America by enhancing the ability of rural communities to develop, to grow, to share in a healthy economy, to realize an enhanced quality of life, and to improve their standard of living by targeting financial and technical resources to areas of greatest need through activities of greatest efficacy.

Organizational Structure

Rural Development's mission area is comprised of Rural Housing, Rural Utilities, and Rural Business-Cooperative programs.

Loan Programs

Rural Development loan programs, with an outstanding portfolio of approximately $106 billion, are delivered through a National Office, 47 state offices, and a network of field offices. The mission area is supported by the Office of the Deputy Chief Financial Officer in St. Louis, Missouri, which provides accounting and service support for all mission area programs, and a Centralized Servicing Center, also in St. Louis, which services the Direct Single Family Housing (SFH) portfolio. The mission area serves 301,396 SFH borrowers; 14,787 Multi-Family Housing (MFH) borrowers; 11,831 Business and Community borrowers; and 1,845 Telecommunications, Electric, Cable TV, Broadband and Distance Learning and Telemedicine borrowers.

In addition, through a network of approximately 3,400 lenders, Rural Development guarantees loans for approximately 241,619 SFH; 210 MFH; 2,747 business & community service; and 19 electric borrowers.

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

The portfolio that follows reflects a total loan portfolio balance higher in fiscal year (FY) 2008 than in FY 2007. There was an increase in the direct portfolio from $76.9 billion to $79.4 billion and the guaranteed portfolio from $22.0 billion to $26.6 billion.

Total Loan Portfolio as of September 30, 2008
FY's 2006 Through 2008
(Dollars in Billions)

	FY 06	FY 07	FY 08
Direct Loans			
Single Family Housing	$13.0	$13.0	$13.2
Multi-Family Housing	11.6	11.6	11.5
Community Facilities/Other	2.2	2.5	2.8
Water & Environmental/Other	8.7	9.3	9.9
Electric	34.2	36.0	37.4
Telecommunications	3.9	3.9	4.0
Business Programs	0.8	0.6	0.6
Total Direct	74.4	76.9	79.4
Guaranteed Loans			
Single/Multi-Family Housing	15.3	17.2	21.8
Community Facilities/Other	0.5	0.6	0.6
Water & Environmental/Other	0.1	0.1	0.1
Electric	0.4	0.4	0.4
Business Programs	3.9	3.7	3.7
Total Guaranteed	20.2	22.0	26.6
Total Loan Portfolio	**$94.6**	**$98.9**	**$106.0**

Rural Business- Cooperative Programs

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

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

The program staff identifies the high risk loans and aggressively monitors the lender servicing activities of slow pay and delinquent borrowers. To control an unacceptable growth in the delinquency rate of the guaranteed loan program, focus has been on oversight to protect the highest risk segments of the $3.7 billion portfolio.

The number of jobs to be created or saved is a critical element in determining the viability of a project for business funding, and is a key performance indicator. The computed number of jobs created or saved is a one-time count credited to each loan when program funds are obligated. The number is based on credible information provided by the borrower and lender during the loan application process, based on a feasibility study or business plan. This information is then entered and tracked in the management database by Rural Development field staff. During the first year of the loan and during subsequent compliance or servicing visits, Rural Development field staffs update and verify the database.

Key Performance Indicator(s)

Rural Business-Cooperative Program Create or save jobs	FY 2008 Target	FY 2008 Actual
Total	72,373	70,476

The objective for jobs created or saved was met. The 2008 target range for meeting the goal is 68,468-75,676. This represents a 5% spread from the projected number.

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

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

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

The purpose of the Rural Business Opportunity Grants (RBOG) is to promote sustainable economic development in rural communities with exceptional needs. This is accomplished by making grants to pay costs of providing economic planning for rural communities, technical assistance for rural businesses, and training for rural entrepreneurs or economic development officials.

Section 9006 Renewable Energy/Energy Efficiency Improvement Program (Section 9006) has awarded over $141 million in grants and over $107 million in loans since 2003. The benefits of the program have included reducing the need for importing oil and reducing green house gas emissions. State Rural Development offices promote and screen applicants for both grants and loans.

The Value Added Producer Grant program provides rural producers the opportunity to enhance their share of revenues received for their processed products. Grants can be used for working capital or feasibility studies. These grants to rural businesses for expansion, modernization or start-up, enhances the local job market mix and improves the local tax base. As a result, the overall local rural economy is stimulated, jobs are created, and quality of life improves for most citizens.

The Rural Cooperative Development Grants are being awarded to nonprofit corporations and institutions of higher education to finance up to 75 percent of the cost of establishing and operating Centers for Cooperative Development. These funds help strengthen the rural economy and assist farmers, ranchers, and rural business owners across the nation in establishing and marketing cooperatives.

The Small Minority Agriculture Producer grants are made to Cooperatives or Associations of Cooperatives whose primary focus is to provide assistance to small, minority agriculture producers and whose governing board and/or membership is comprised of at least 75 percent minority.

The Socio-Economic Benefit Assessment System, or SEBAS was implemented by Rural Business Staff (RBS) for the Business and Industry (B&I) and Energy Loan programs in Fiscal Year 2007. SEBAS assesses the effectiveness of Rural Development Business and Cooperative B&I and Energy programs in measures of local and regional economic performance. SEBAS provides an evaluation of the geographic dispersion of the B&I investments' social and economic effects by measuring impacts at the county, region and state levels. Following the collection of sufficient data, SEBAS will compute indirect hiring, local taxes collected, and the change in Gross Domestic Product (GDP) for funds obligated in each rural county, region, and state.

In Fiscal Year 2008, SEBAS was used to calculate jobs created/saved and Gross Domestic Product (GDP). However, the calculation for jobs in SEBAS has a displacement factor that results in a significant reduction in the jobs created/saved for the programs. The performance goals for each year will continue to be calculated in the previous format, and due to the lack of consecutive years of data in SEBAS, adjustments to the goals will need to be made until FY 2012.

Implementation of SEBAS for the Intermediary Re-lending Program (IRP) was completed in FY 2008. SEBAS will look at the industry and jobs created/saved by the ultimate recipient to measure the economic impact of the program.

Key Performance Indicator(s)

Rural Business – Business & Industry Guaranteed Loans and Grants	FY 2008 Target	FY 2008 Actual
Delinquency rate (excluding bankruptcy cases)	10.5%	7.42%
Small Businesses Assisted	12,657	13,176
Millions of kWh generated	682	1,120

All key performance indicator targets were met.

Community Development Programs

Effective community development involves multiple partners working together on an effort that is long-term (often 10 years or more) and comprehensive (covering jobs, education, health care, water quality, and many other aspects of community life). Community leaders and citizens are the lead players in developing and implementing a local strategic plan. In many distressed rural communities (reflected in high poverty rates, high unemployment rates, and/or high outmigration rates), USDA-Rural Development is a critical partner in successful community development.

USDA-Rural Development often performs two functions in ensuring that a distressed community can develop and implement a successful approach to community development. First, USDA-Rural Development provides funding for both the creation and the implementation of a community's strategic plan. For instance, over the past decade, 61 highly distressed communities have been provided multi-year grants through the Empowerment Zone-Enterprise Community (EZ/EC) program and through the Rural Economic Area Partnership (REAP) Zone program. Second, USDA-Rural Development staff provides technical assistance on key community development skills such as strategic planning, nonprofit board responsibilities, and fiscal management; this technical assistance is often vital for the success of a community's work. In addition, community development technical assistance has provided assistance to distressed rural communities designated as Champion Communities.

For USDA-Rural Development to effectively serve its customers and provide the high quality technical assistance that will enable distressed communities to thrive, strong staff competence in community development skills is necessary. Thus, USDA-Rural Development staff training is an essential element of community development success.

Among the dozens of possible indicators of effective community development, only two are presented here. These indicators underline two key aspects of successful community development: 1) the creation and maintenance of a strong job base is a necessary ingredient for every community; and 2) each community must reach far beyond USDA-Rural Development for the financial resources needed to implement its strategic plan and build a vibrant community.

Key Performance Indicator(s)

Community Development Programs	FY 2008 Target	FY 2008 Actual
Number of jobs created and saved in Rounds I, II and III EZ/EC/CC & REAP Communities	1,500	3,640
Rounds I, II & III EZ/EC/CC & REAP communities' leveraged dollars	$850,000,000	$434,650,072

While the number of jobs created did increase, leverage has fallen because of cutbacks in both federal and private sector funding availabilities. Two of the EZ/EC's encountered problems that prevented plan conformance.

The actual numbers presented are generated using the Benchmark Management System (BMS). BMS is used to track the progress that each community is making in achieving its various objectives, including the creation and saving of jobs and the leveraging of dollars.

Housing & Community Facilities Programs

Single Family Housing

Housing & Community Facilities programs improve the quality of life in rural America by building competitive, vibrant rural communities.

To promote homeownership, Rural Development provides financing, with no down payment and at favorable rates and terms, either through a direct loan or a loan from a private financial institution, which is guaranteed. The Single Family Housing Direct (SFH-D) Loan Program has the most loans in the housing portfolio. SFH-D loans are made to families or individuals with very-low and low incomes to buy, build, improve, repair, and/or rehabilitate homes in rural areas. These loans are repayable over 33 years (with a maximum repayment of 38 years) at an effective interest rate as low as 1 percent annually. Low-interest loans and grants enable very-low income rural Americans to remove health and safety hazards in their homes and to make homes accessible for people with disabilities.

Rural Development also guarantees loans through partnerships with approximately 3,400 lenders and the number is expected to expand. Loans may be guaranteed for an amount not to exceed 90 percent of the loan amount. Guaranteed loans are available for low and moderate-income families. These loans are repaid over 30 years with the interest rates negotiated between the customer and lender. The guaranteed loan program reflects the commitment to achieve maximum leveraging of the federal loan funds.

With the housing crisis now affecting lenders nationwide, USDA's guaranteed program is one of the few remaining mortgage programs providing no down payment loans. While the program maintains its strict underwriting criteria, demand for the program has skyrocketed to historic levels. The number of guaranteed home loans being provided by USDA has increased by more than 76 percent to an all-time high of 62,320 obligated during the year.

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

Key Performance Indicator(s)

Single Family Housing	FY 2008 Target	FY 2008 Actual
Number of rural households receiving financial assistance for housing.	54,318	72,151

In FY 2008, USDA assisted 72,151 households with homeownership opportunities. Of this number, 9,831 were provided through the Section 502

Direct Loan program and 62,320 through the guaranteed program. Another 11,209 Very Low income homeowners received assistance with Section 504 repair loans or grants and 348 with subsequent Section 502 Direct loans.

Targets were exceeded in part because of the additional funding available as a result of hurricanes and other natural disasters. Reported homeownership opportunities included 5,922 provided with Hurricane Supplemental and Natural Disaster Funds. An additional 706 households obtained Section 504 Repair loans and grants from these special allocations.

The average loan increased 6.2 percent as prices for modest homes remained strong. Even as the overall real estate market has cooled, strong demand for both Direct and Guaranteed loans is expected to continue as these programs draw greater interest from lenders and affordable home buyers.

For Direct SFH loans, delinquency rates provide a good indicator of how well the accounts are monitored and supervised as well as “output” as it is a measure of those obtaining financing that are successful and are building homeownership equity.

Key Performance Indicator(s)

Single Family Housing	FY 2008 Target	FY 2008 Actual
Delinquency Rate (Direct loans only)	Within 200 basis points of Federal Housing Administration (FHA) Rate	Rate is 83 basis points below FHA.
Delinquency Rate (Guaranteed loans)	Within 50 basis points of FHA Rate	Rate is 482 basis points below FHA

The June, 2008 FHA gross delinquency rate was 14.87 percent, with SFH-D at 14.04 percent. This exceeds the target of being within 200 basis points of the FHA by 283 basis points. (The June 2008 rate is the latest published FHA statistic. This statistic includes all delinquent loans such as bankruptcies and foreclosures in process for SFH-D and FHA.)

SFH-D year-end (September 30, 2008) delinquency of 15.8 percent is above the previous year rate of 14.4 percent. The increase results from the weakening in the national housing market and the downturn in the overall economy.

The Single Family Housing Guaranteed (SFH-G) loan delinquency rate net of foreclosures was 10.05 percent in June, 2008. This rate is significantly below the FHA rate, exceeding the target for FY 2008.

The SFH-G rate in September, 2008, at 11.24 percent (net of foreclosures) is up from the September 2007 rate of 10.52 percent. The delinquency rate, while better than FHA's, has been affected by a declining housing market and troubles in the general economy.

It is important to note the Rural Development housing delinquency rate for both the Direct and guaranteed programs compare favorably to other private and government-sponsored lenders. Despite serving a similar (or even lower income) clientele, Rural Development has maintained strong underwriting standards and reasonable servicing measures to allow its lower income families to succeed as homeowners.

Multi-Family Housing Programs

The Multi-Family Housing (MFH) program finances rural rental housing (RRH), farm labor housing, and cooperative housing for low income and elderly residents in rural communities of fewer than 10,000 in population.

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

The farm labor housing program enables farmers, public or private nonprofit organizations, and units of state and local governments to develop or rehabilitate farm labor housing. Seasonal and year-round workers benefit from farm labor housing loans and grants by having safe, affordable housing.

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

To maintain an aging long-term quality portfolio, Rural Development has assessed the capital needs of its MFH portfolio to develop a long-term strategy for preserving projects in the portfolio for low-income residents. The result of these assessments established a section 515 multi-family portfolio revitalization program to provide for the 20 year deferral of repayments on existing debt, in exchange for project sponsors making necessary investments for the repair and rehabilitation of their projects.

Sustaining a low delinquency rate is an indicator to illustrate that the MFH loan portfolio is managed in a manner that is efficient and effective. Rural

Development's goal to provide more quality housing to improve the lives of rural residents is achieved when delinquency and losses are minimized. By minimizing losses, the availability of affordable housing for eligible rural residents is maintained.

Key Performance Indicator(s)

Multi-Family Housing	FY 2008 Target	FY 2008 Actual
Number of projects with accounts more than 180 days past due	200	221

The MFH portfolio continued its revitalization program; however, the impacts of loan restructuring are a long-term effort. We have noticed a small upswing in 180 day delinquencies and field staff continues to work with borrowers to implement work-out plans.

Key Performance Indicator(s)

Multi-Family Housing	FY 2008 Target	FY 2008 Actual
Total number of units selected for funding for New Construction	12,211	4,411
Total number of units selected for funding for preservation	5,515	8,281
Decrease in number of families in substandard housing in the MFH portfolio	2,340	2,113
Decrease in number of families in the MFH properties paying more than 30 percent of income in rent	67,000	65,958
Increase the amount of leveraged funds in Rural Rental Housing for both New Construction and rehabilitation	$624,000,000	$1,173,229,234

The number of New Construction units was 4,411 which is an increase from 2007 because of an increase in the allocation of funding of the Rural Rental Housing Loans from New Construction towards rehabilitating existing properties. The number of new construction units was also impacted by a lower amount of Guaranteed Rural Rental Housing (GRRH) Loan funds used for New Construction and a greater emphasis on using these guaranteed funds for rehabilitation of existing affordable housing.

The number of units selected for preservation funding was higher than the target by more than 25 percent. This increase can be attributed to several factors; the MFH Preservation and Revitalization efforts, the use of the Guaranteed Rural Rental Housing program rehabbing existing affordable housing properties, and the increased amount of leverage used in these rehabilitation deals, thereby allowing more units to be renovated per program dollar.

There was no significant change in the decrease of numbers of families living in substandard housing from the prior year.

The number of families paying more than 30 percent of their income towards rent decreased again in FY 2008; the actual number was lower than the target by more than 1,000 families. This continues the Program's efforts to better manage rental assistance and target utilization of assistance to those properties where the need is greatest. The Rental Assistance Program provides project-based rental assistance payments to property owners to subsidize the tenants' rent at an affordable level. By providing rental assistance, resources are directed to those rural communities and customers with the greatest need for housing.

The amount of leverage attracted to Multi-Family Housing properties has increased by almost 90 percent. An increased emphasis in leveraging preservation transactions helped us in exceeding our goal. A greater emphasis is being paid to attracting additional outside funds to these new construction and preservation transactions.

Community Facilities Programs

Community Facilities (CF) programs offer both direct and guaranteed loans to public entities such as municipalities, counties, and special purpose districts, as well as nonprofit corporations and Indian tribes. These loans improve the quality of life of rural residents by providing access to modern, essential community facilities such as hospitals and health care clinics; fire, rescue and public safety facilities; educational facilities; nursing homes and assisted living facilities; and child and adult day care facilities. Recipients must demonstrate that they are unable to obtain financing from commercial sources. The term of the loan will be the useful life of the facility financed, State statute, or 40 years, whichever is less.

Historically, the largest dollar volume and number of loans and grants have gone to finance health care and public safety projects. Approximately 60 percent of CF projects fall into these two categories. Therefore, the two types have been chosen as performance measures for purposes of the Program Assessment Rating Tool (PART). The availability of these types of facilities is inarguably of vital importance in the current world climate. At the same time, these facilities are increasing in technological complexity and expense, putting them beyond the financial reach of many rural, isolated communities. Data for these measures is derived from actual obligations as reflected in the Guaranteed Loan Accounting System.

Key Performance Indicator(s)

Community Facilities	FY 2008 Target	FY 2008 Actual
Increase the percentage of the rural population with access to improved health care services by 5.5 percent by 2010	5.7%	4.8%
Increase the percentage of the rural population with access to improved safety to 3 percent by 2010	3.0%	5.7%

Given the realities of the CF program operations, FY 2008 has been a successful year. While the health care target was not quite met, the public safety goal was significantly more successful than projections. Individual communities determine their needs, including the timing and financial structure of development, based on various factors unique to each situation. Rural Development has no influence on the type or number of applications it receives in a particular year. However, more than 60 percent of the projects approved for this year fell into our two priority categories. Overall, more than 14 million rural Americans will enjoy an improved quality of life directly attributable to the $682 million investment in essential community facilities.

Utilities Programs

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

Electric Programs

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

The Electric programs make loans and loan guarantees to finance the construction of electric distribution, transmission and generation facilities, including system improvements and replacement required to furnish and improve electric service in rural areas. Rural Development makes loans to corporations, states, territories, subdivisions, and agencies such as municipalities, utility districts, and cooperative, nonprofit, limited-dividend, or mutual associations that provide retail electric service needs to rural areas or power supply needs of distribution borrowers in rural areas. The program staff services approximately 674 active electric borrowers in 46 states, plus active territories of Marshall Islands, Puerto Rico, and American Samoa.

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

Guaranteed loans are provided by Rural Development primarily through the Federal Financing Bank (FFB); however, guarantees have also been provided to the National Rural Utilities Cooperative Finance Corporation, and the CoBank. The FFB is an agency within the U.S. Treasury providing funding in the form of loans for various government lending programs, including the Rural Development Utilities programs, Electric programs, and Guaranteed loan programs. FFB loans are guaranteed by Rural Development and are available to all electric borrowers.

The Rural Development electric program borrowers in the United States (U.S.) include 622 Distribution and 52 Generation and Transmission cooperatives. Cooperatives serve approximately 40 million people in 47 states, 17 million businesses, homes, schools, churches, farms, irrigation systems, and other establishments in 2,500 of 3,141 counties. Cooperatives serve approximately 12 percent of the nation’s population covering 75 percent of the nation’s landmass.

Due to the lack of densities, electric cooperatives generate less revenue per investment than other electric utilities. Electric cooperatives serve an average of 7 consumers per mile of line and collect annual revenue of approximately $10,565 per mile of line. Investor-owned utilities average 35 customers per mile of line and collect $62,665 per mile of line, while publicly owned utilities, or municipals, average 47 consumers and collect $86,302 per mile of line.

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

Key Performance Indicator(s)

Electric Loans – Direct and Guaranteed Loans	FY 2008 Target	FY 2008 Actual
Number of electric programs borrowers' consumers receiving new or upgraded electric service	7,125,000	8,093,291
Dollar amount of consumers receiving new or upgraded electric service	$7,100,000,000	$7,100,000,000

The key performance indicator targets all were met.

The Electric Programs exceeded target measures by a small amount due to complete obligation of all program funds.

Telecommunications Program

In order to meet the goal of increasing economic opportunity in rural America, USDA annually finances new construction and upgrades to telecommunications infrastructure. Access to high-speed Internet services and other quality telecommunications services increases educational opportunities, improved availability of healthcare, job creation, retention and growth of businesses and other economic growth.

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

Over the past 3 years, more than $2.8 billion in loans have been provided to 156 entities for the deployment of advanced, state-of-the-art telecommunications networks serving rural areas. The facilities financed with these loans must be capable of offering high-speed service to all subscribers that request it. The primary technologies used to deliver this service are "digital subscriber line" - or DSL - service and "fiber-to-the-home" - or FTTH – systems, although other technologies are also deployed.

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

Key Performance Indicator(s)

Telecommunication	FY 2008 Target	FY 2008 Actual
Number of borrowers' subscribers receiving new and/or improved service	194,931	182,175
Percentage increase of borrowers' subscribers receiving new and/or improved service compared to FY 07	5.7%	17.4%
Leveraging of telecommunications financial assistance (private investment to Rural Development funding)	$3.00:1	$3.04:1

The Telecommunications Program exceeded their primary performance measure of increasing the percentage of subscribers receiving new and/or improved service under loans financed primarily because of a large loan obligation originally scheduled for FY 07 was actually obligated in the first quarter of FY 08.

The Distance Learning and Telemedicine Program

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

Key Performance Indicator(s)

Distance Learning and Telemedicine	FY 2008 Target	FY 2008 Actual
Number of schools receiving distance learning facilities	700	972
Number of healthcare providers receiving telemedicine facilities	690	541
Leveraging of telemedicine and distant learning financial assistance (private investment to Rural Development funding)	$1:$1	$0.61:$1

While numbers of schools receiving funding increased significantly, healthcare provider funding for telemedicine facilities fell from initial projections. The economy negatively impacted private sector funding availability, which impacted leveraged dollars.

Broadband Program

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

The building and delivery of advanced telecommunications networks are having a profound effect on our Nation’s economy, its strength, and its growth. Broadband networks in small rural towns will facilitate economic growth and provide the backbone for the delivery of increased educational opportunities over state-of-the-art telecommunications networks. Just as our citizens in our cities and suburbs benefit from access to broadband services, so should our rural residents. In rural America, access to broadband plays a vital role in solving the problems created by time, distance, location, and lack of resources. Broadband is a tool that allows people, communities, and organizations to consider new and different ways to interact, manage their lives, and do business.

Key Performance Indicator(s)

Broadband	FY 2008 Target	FY 2008 Actual
The number of borrowers' subscribers receiving new or improved broadband service	200,000	593,167
Percentage growth of borrowers' subscribers receiving new or improved service	31.49%	195%

The Broadband program significantly exceeded the performance indicator projections due to the success of the program and additional funding made available from the Farm Security and Investment Act of 2002 (2002 Farm Bill).

Water and Environmental Program

Safe drinking water and sanitary waste disposal systems are vital not only to public health, but also to the economic vitality of rural America. Rural communities across the country are facing the challenges of aging infrastructure, increased yet unfunded environmental mandates, contaminated or diminished water sources, and increased construction costs. As these communities seek to provide safe, reasonably priced water and wastewater services to their residents, access to affordable financing is critical.

Water and Environmental Program (WEP) loans and grants are provided to rural communities for the development, replacement, or upgrading of water and environmental facilities. Direct loans are repayable up to 40 years. One of the objectives of the WEP program is to provide rural residents with modern and affordable water and waste disposal services. Another objective is to direct program resources to those rural communities with the greatest need. This includes rural communities that are poverty-stricken as a result of out-migration, natural disasters or economic stress due to Federal actions.

Key Performance Indicator(s)

Water and Environmental	FY 2008 Target	FY 2008 Actual
Customers served by new or improved water & waste disposal facilities	1,380,000	4,361,972

In FY 2008, WEP invested $1.82 billion in direct and guaranteed loans and grants to provide technical assistance to rural communities and help them develop water and waste disposal facilities.

Rural Development anticipated serving 345,000 program borrowers' customers (subscribers) quarterly and 1,380,000 on an annual basis. Quarterly targets for this measure are based on projected annual measures developed in conformance with The Program Assessment Rating Tool (PART), and the expected program level to be received each fiscal year. We exceeded our performance targets except for the first quarter when we received limited funding for projects before we received our full budget. We surpassed our goal for FY 2008 by serving 4,361,972 program borrowers' customers (subscribers). Several contributing factors are listed below:

- Rural Development monitors its output and outcome measurements to evaluate its program delivery and services to its customers. Rural Development establishes national and state goals and has exceeded the annual targets used to measure the loan to grant mix and referrals to commercial credit. Rural Development State offices continually coordinate their strategies to strengthen relationships with partner agencies and organizations by leveraging funds for project development. The results demonstrate that Rural Development is able to target funds to more communities and projects where the financial investments result in a greater number of borrowers' customers being served.

- Rural Development has offered more training to the National and State office staffs to sharpen skills in using underwriting tools. Our performance continues to improve in determining those communities that can afford maximum debt capacity. The result is that the WEP programs reach more communities needing Federal assistance.

- Rural Development uses a "use or lose" policy for funding, which spurs rapid obligation activity over the third and fourth quarters.

- On August 15, 2008, just 85 days after the enactment of the 2008 Farm Bill, Rural Development invested over $355 million of Farm Bill funding in 176 projects. The funding translated into a program level representing 77 percent loans, and 23 percent grants. Another $189 million in 2008 annual appropriations was utilized to fund additional projects and was announced on August 15. The extraordinary effort will ensure that communities across rural America will have access to clean drinking water, as well as sewer and solid waste systems. The funding made available from the Farm Bill enabled the Water Programs to exceed targets in several areas.

- Rural communities must increase investment in water and wastewater facilities to upgrade aging facilities, meet new quality standards and increase the security of their operations.

- The trend for many water and sewer systems, especially drinking water, is to develop more regional projects that would serve a larger customer base.

Future Opportunities and Challenges

Rural Development is impacted by changes occurring in society and the economy locally, nationally and the world as a whole. New authorities have been granted to Rural Development as a result of the Food, Conservation, and Energy Act of 2008 (The Farm Bill) to address changes in agriculture and the rural economy and create a broader range of economic opportunities for farmers and rural businesses. In addition, Rural Development is continually evaluating its business practices to ensure they are both efficient and effective, resulting in new technologies, initiatives, systems, and policies. Some opportunities and challenges from these changes are summarized in the following areas:

Technology

Rural Development continues to implement enhancements to a web-based automated guaranteed underwriting system (GUS) for guaranteed program loan lenders to allow more efficient review and approval of loan applications for select Rural Development program loans.

Within Rural Development, initiatives such as continued enhancement of the Data Warehouse provide employees with faster and easier access to data that crosses all business lines. This initiative is underpinning all automation support efforts to create a single, authoritative source of data. The demand to geo-code tabular loan data continues to grow at a significant pace. Maps are now available to the public to display eligible areas for Rural Development programs.

The growing concern about personal and job-related security has resulted in the development of elaborate plans for safeguarding personal identifiable information and continuing business in emergency situations as well as strengthened protection of business data within our information systems.

Performance Improvement Initiative

The Federal Budget and Performance Integration Initiative was renamed as the Performance Improvement Initiative to refocus federal agency program improvement endeavors, making agencies more accountable for the quality and aggressiveness of program goals, performance improvement plans, and annual improvements in program performance. The Initiative provides information on program performance to help the President and Congress make better, more informed decisions about the programs.

To ensure successful implementation of the initiative, Rural Development appointed Performance Improvement Officers (PIO) for its three operational agencies as well as a Rural Development PIO to ensure coordination. Performance Improvement Officers are responsible for coordinating the program performance improvement activities, providing leadership in the development and improvement of the RD strategic plan, developing annual performance plans and annual performance reports, and ensuring the use of such information in agency budget justifications.

Quantified performance goals have been established in the performance standards for Rural Development's senior managers in the National Office and the 47 State Directors responsible for the delivery of most RD programs at the state level. Several performance measures were put in place to require specific data collection methodologies and additional investments and resources for modifications to existing data collection systems or the development of new systems.

Financial Management and Accounting

Rural Development is supporting the USDA Financial Management Modernization Initiative (FMMI). The Office of the Chief Financial Officer (OCFO) is replacing its legacy financial system with a Financial System Integration Office/Joint Financial Management Improvement Program (FSIO/JFMIP)—a certified, commercial-off-the-shelf (COTS) software package that will provide online, real-time transaction capability and access to both Department-level offices and all agencies. This effort includes a large-scale implementation to consist of systems integration, business process reengineering and production support.

The primary goal of the FMMI is to improve financial performance by providing the US Department of Agriculture (USDA) with a modern, efficient core financial management system that complies with Federal accounting and systems standards and provides maximum support to the USDA mission.

The FMMI will include integration with financial and administrative feeder systems, realignment of affected business processes, and clear communication to stakeholders. Real-time transaction processing and updates, including immediate budget updating, will provide users and managers access to the most up-to-date information for an accurate view of available funds and greatly improved management information and reporting.

Budget and Performance Management System

The Budget and Performance Management System (BPMS) is a multi-Agency investment with the purpose of improving budget and financial management operations. BPMS will include business process modernization, improved tools to perform budgeting and resource management functions, better management information for decision makers, and the integration of budget and performance data through the modernization of data collection and reporting systems.

Pioneered by the Farm Services Agency (FSA), Rural Development is partnering with the Food Safety and Inspection Service (FSIS), Foreign Agricultural Service (FAS), and Information Technology Services (ITS) to financially support the project. BPMS provides most elements of The Office of Management and Budget initiative of Budget Formulation and Execution (BF&E) Line of Business (LOB) solution. These elements include budgeting, planning, forecasting, business modeling, and optimization. Other elements in this project include activity based costing/managerial cost accounting with scorecard applications, financial consolidation, and statutory and financial reporting.

Credit Management Review Council

The United States Department of Agriculture Office of the Chief Financial Officer (OCFO) has initiated a USDA-wide initiative to improve the performance of its major credit programs. A key element is improvement of the oversight and management of the credit portfolios.

In order to assist the OCFO's initiative, Rural Development established the Credit Management Review Council (RD-CMRC) to ensure executive oversight of credit portfolios in Rural Development. The RD-CMRC will assess the performance of the credit programs through the establishment of risk standards and the measurement of performance against these standards. The goals are to reach target borrowers, reduce the deviation from risk standards, reduce the unit cost of servicing and liquidating loans, improve the rate of debt recovery, and achieve customer satisfaction ratings that meet or exceed industry standards.

The key objectives of the RD-CMRC are to ensure sound financial management of Rural Development's credit programs. The RD-CMRC is responsible for the review and approval of all program management techniques required under the PMA credit scorecard, as well as additional best-in-business practices.

Multi-Family Housing (MFH)

Recent court decisions have given numerous MFH borrowers the opportunity to pay off their debt to Rural Development and use the property for something other than housing low income families. As a result of this action, rural America may lose a number of rental housing projects dedicated to housing low income families and the tenants living in these properties, many of whom are receiving rental assistance through Rural Development, will lose their access to rent subsidies. Rural Development will strive to minimize the impact on the existing tenants, including providing vouchers to tenants in those projects that have left our program, and to retain as many of these projects for low-income housing purposes as possible.

Direct Single Family Housing

Rural Development has a direct Single Family Housing (SFH) portfolio of nearly 318,615 loans valued at $13.3 billion. These loans are made to low and very low income families and a small percentage of them result in foreclosure. The carrying cost of a loan in foreclosure is significant. Since foreclosures are subject to state law, each state has different requirements and the management of the foreclosure has traditionally been a state office responsibility. To help minimize the carrying costs and ensure foreclosures are consistently managed, Rural Development is centralizing the management of loans in foreclosure at its SFH Centralized Servicing Center. As of fiscal yearend, foreclosures from 22 states have been centralized.

Changes in Agriculture and the Rural Economy

While farming continues to be an important component in the economy of many rural areas, the rural economy is changing. Out of more than 2,100 non-metro counties, 585 rural counties are manufacturing-dependent, and 403 are farming-dependent, and the remainder rely on services including mining or government. Fewer than 20% of non-metro counties today are farming-dependent. Agriculture remains a main economic driver in many rural areas, with many rural businesses dependent on farming, such as those in farm supply, product handling and storage, processing, and technical services. However, the rural economy is growing more diverse and is increasingly linked to a global economy. Not only sharp fluctuations in farm prices, but also changes in interest rates, unemployment rates, and the stock market can impact the ability of farmers, other rural residents, communities and businesses to qualify for credit, manage debts, and create employment and investment opportunities to grow their local economies.

Farm Bill

The Food, Conservation, and Energy Act of 2008, the Farm Bill, enacted into law in June 2008, will govern the bulk of Federal agriculture and related programs for the next 5 years. New authorities granted to Rural Development are targeted to address changes in agriculture and the rural economy and create a broader range of economic opportunities for farmers and rural businesses. The Farm Bill reauthorized or created new programs to help increase credit availability and technical resources for rural businesses. The Farm Bill funds the planning, coordination, and implementation of rural community and economic development programs. It emphasizes value-added agricultural activities, renewable energy, and locally and regionally produced agricultural products. The Farm Bill prioritizes broadband expansion to underserved areas and establishes a regional collaborative investment program.

The alternative fuel industry is developing rapidly providing additional opportunities to farmers and ranchers to market their products as well as the ability to use by-products of their existing operation as an additional source of income. The Farm Bill renamed the Section 9006 renewable energy program as the Rural Energy for America Program (REAP) to provide grants and loan guarantees for renewable energy systems and energy efficiency projects for farmers and ranchers and small rural businesses.

The Farm Bill created the Rural Collaborative Investment Program establishing a national framework to address the relative rural disadvantage in federal funding commitments for economic development and community resources. The program builds an innovative approach to enhance regional rural competitiveness in a global economy by better aligning public, private and philanthropic investments in rural America.

The Farm Bill authorizes a new Rural Endowment Loan Program to provide long-term loans to community foundations to assist in the implementation of regional development strategies.

Entity's Systems, Controls, and Legal Compliance

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

Section 2

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

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

In FY 2007, Rural Development reported a new material weakness related to the credit reform re-estimation process. Based on improvements made over the quality control of the re-estimation process this weakness was reassessed and reported as a significant deficiency for FY 2008.

Section 4

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

For FY 2008, Rural Development provides reasonable assurance that internal control, and financial management systems meet the objectives of FMFIA.

Rural Development has fulfilled the requirements for documenting and testing of internal controls as directed by OMB Circular Number A-123, Management Accountability and Control. Based on these assessments, Rural Development can provide assurance that internal controls over financial reporting are operating effectively.

Improper Payments Information Act of 2002

The Improper Payments Information Act of 2002 requires that the head of each agency annually review all programs and activities the agency administers to identify those that may be susceptible to significant improper payments. For each program or activity identified, the agency is required to estimate the annual amount of improper payments and, if the estimate is over $10 million, report the estimate to Congress along with the actions the agency is taking to reduce those improper payments.

Rural Development responded that all of its applicable programs had been assessed and reported that the Rural Development mission area had only one program, Section 521 Rental Assistance, identified as potentially being susceptible to significant improper payments and meeting the requirements for a statistically valid estimate of improper payments.

	Reported in FY 2006	Reported in FY 2007	Reported in FY 2008
Outlays	$569 M	$854.5 M	$886.9 M
Improper Payment Rate %	3.49 %	3.07 %	3.95 %
Improper Payments $	$22 M	$26.3 M	$35.0 M
Year of data sampled	*	FY 2006	FY 2007

*FY 2006 results were based on partial samples of the FY 2006 information. Starting with FY 2007 reporting, the statistical sample was based on the entire prior fiscal year.

The future target rates for future years are:

Future Targets for Improvement	2009	2010	2011
Estimated Outlays*	$923.7M	$960.6M	$999.0
Improper Payment Rate	4.0%	3.7%	3.5%

*Based on anticipated increase of 4 percent per year

Rural Development implemented a corrective action plan. A statistical sampling plan for use in estimating the error percentage and amount of improper payments has been developed. The Rural Development plan is based on a review of Multi-Family Housing tenants receiving rental assistance (RA) payments from a universe of 3,326,352 or .020 percent. This methodology produced a sample with a 99 percent confidence level. This year, the agency used the audit staff from the Centralized Servicing Center (CSC) to undertake the study, rather than Rural Development field staff used for previous reports. The study required CSC to evaluate tenant files and income calculations.

The universe of rental assistance payments made during FY 2007 was 3,326,352. The only parameter used to determine the eligible universe was the RA payment. No other data element, such as location, size of property, number of units or availability of other rental assistance (such as Section 8) was a consideration. The statisticians were provided a data extract from the Multi-Family Housing Information System (MFIS). The extract contained a list of all tenants receiving RA during FY 2007. The data included month of payment, project name, project identifier (case number/project number) and tenant name and unit number. From the data extract, the statisticians selected the sample by a systematic sample technique. Once the sample was identified, a memo was sent to the borrowers/management agents that explained the process (including detailed instructions), provided the list of tenant payments to be reviewed and provided a list of documents that needed to be provided to CSC for their review. The data received from the borrower/management agent was used to compare with Agency records. The study required CSC to complete the survey for the selected tenant payments. There was to be no substitution of the selected payment and, if the management agent was unable to submit the file, the payment would be considered improper.

The IPIA survey results for this year are higher than prior years. We attribute this to a more controlled, consistent, and accurate review, rather than an actual increase in error rate. We expect subsequent surveys will also be performed by CSC, which we believe will provide more comparable data on which to measure IPIA improvements.

Other corrective action items are listed below:

On May 27, 2008, letters were sent to property management business partners regarding the importance of the IPIA process and the types of errors that were identified. This required industry groups to develop corrective action plans to be undertaken by their members.

The goal to implement a quarterly audit process will be conducted by CSC on selected states tenant files by December 31, 2008.

Errors found in the FY 2008 report were followed up by the Agency for corrective actions and this process was completed on July 31, 2008.

On May 28, 2008, an unnumbered letter was issued to the State Offices regarding the findings from this report. The unnumbered letter will require State Offices, with an average error rate of 2% or higher during the past three years, to develop a corrective action plan. The plan will need to include procedures to train field staff, borrowers and property managers in appropriate required documentation and follow-up with tenants and income-verifiers.

The National Office continues to pursue access to the HHS New Hires data and HUD's Enterprise Income Verification (EIV) System to be shared with State Offices and management agents.

On February 28, 2008, HB-2-3560 was added to the Multi-Family Housing Asset Management Handbook, Chapter 6 – Project Occupancy. This included a check sheet for property management agents to review when verifying assets, income and adjustments to income, and a check list of required tenant file documentation.

By October 31, 2008 a “Fact Sheet” will be developed for MFH tenants explaining their responsibilities and rights regarding income disclosure and verification.

A process is in place to recover improper payments including offsets, the use of private or public collection agents, and any other remedies available.

Variance Allowances

In accordance with Office of Management and Budget (OMB) Circular A-136, Financial Reporting Requirements, Rural Development is required to prepare annual analysis of variances in the quarterly financial statements. The variances shown are significant as defined by USDA as those greater than 10 percent and $100 million for consolidated statements, and greater than 25 percent and $25 million for components.

Rural Development is reporting a 12 percent increase in Fund Balance with Treasury reflected in the fiscal year 2008 Consolidated Balance Sheet. The variance was largely due to increases in cash received in the Electric and Telephone Cushion of Credit Accounts. Also, in late FY 2008 additional funding was provided for disaster assistance.

In FY 2008, the implementation of a new credit reform cash flow model (non housing) resulted in a large increase of net cost of operations. Improvements made in the model resulted in upward re-estimates for the electric, telecommunications, and water and environmental programs.

Budgetary offsetting collections decreased approximately 9 percent as a result of less FY 2008 collections in the electric liquidating program as compared with the collection in FY 2007 related to the electric Credit Reform modification.

DEPARTMENT OF AGRICULTURE
RURAL DEVELOPMENT
CONSOLIDATED BALANCE SHEET
AS OF SEPTEMBER 30, 2008 AND 2007
(In Millions)

	2008	2007
Assets (Note 2):		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	$ 8,717	$ 7,778
Accounts Receivable, Net (Note 5)	0	1
Other (Note 8)	1	0
Total Intragovernmental	8,718	7,779
Cash and Other Monetary Assets (Note 4)	125	109
Accounts Receivable, Net (Note 5)	1	0
Loans Receivable and Related Foreclosed Property, Net (Note 6)	69,733	68,372
General Property, Plant and Equipment, Net (Note 7)	62	65
Other (Note 8)	37	36
Total Assets	**78,676**	**76,361**
Liabilities (Note 9):		
Intragovernmental:		
Accounts Payable	5	3
Debt (Note 10)	66,423	62,931
Resources Payable to Treasury (Note 1N)	6,043	6,171
Other (Note 11)	1,027	1,320
Total Intragovernmental	73,498	70,425
Accounts Payable	16	64
Loan Guarantee Liability (Note 6)	1,057	948
Federal Employee and Veteran Benefits (Note 9)	31	28
Other (Note 11)	270	173
Total Liabilities	**74,872**	**71,638**
Commitments and Contingencies (Note 12)		
Net Position:		
Unexpended Appropriations	4,535	4,788
Cumulative Results of Operations	(731)	(65)
Total Net Position	**3,804**	**4,723**
Total Liabilities and Net Position	**$ 78,676**	**$ 76,361**

The accompanying notes are an integral part of these statements.

DEPARTMENT OF AGRICULTURE
RURAL DEVELOPMENT
CONSOLIDATED STATEMENT OF NET COST
FOR THE YEARS ENDED SEPTEMBER 30, 2008 AND 2007
(In Millions)

	2008	2007
Program Costs (Note 13):		
Intragovernmental Gross Costs	$	$
Borrowing Interest Expense	3,514	3,758
Other	344	362
Total Intragovernmental Gross Costs	3,858	4,120
Less: Intragovernmental Earned Revenue (Note 14)	360	314
Intragovernmental Net Costs	**3,498**	**3,806**
Gross Costs with the Public:		
Grants	1,795	1,736
Loan Cost Subsidies	1,322	193
Other	1,241	631
Total Gross Costs with the Public	4,358	2,560
Less: Earned Revenues from the Public (Note 14)	4,183	4,430
Net Costs with the Public	**175**	**(1,870)**
Net Cost Of Operations	**$ 3,673**	**$ 1,936**

The accompanying notes are an integral part of these statements.

DEPARTMENT OF AGRICULTURE
RURAL DEVELOPMENT
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
FOR THE YEARS ENDED SEPTEMBER 30, 2008 AND 2007
(In Millions)

Cumulative Results of Operations	**2008**	**2007**
Beginning Balances:	$ (65)	$ 225
Adjustments		
Changes in Accounting Principles	0	0
Corrections of Errors	0	0
Beginning Balances, as Adjusted	**(65)**	**225**
Budgetary Financing Sources:		
Appropriations Used	3,125	3,039
Transfers-In/Out Without Reimbursement	(244)	(1,573)
Other Financing Sources:		
Transfers In/Out Without Reimbursement	0	0
Imputed Financing	126	180
Total Financing Sources	**3,007**	**1,646**
Net Cost of Operations	(3,673)	(1,936)
Net Change	(666)	(290)
Total Cumulative Results of Operations	**$ (731)**	**$ (65)**

Unexpended Appropriations	**2008**	**2007**
Beginning Balances:	$ 4,788	$ 5,172
Adjustments		
Changes in Accounting Principles	0	(52)
Corrections of Errors	0	0
Beginning Balances, as Adjusted	**4,788**	**5,120**
Budgetary Financing Sources:		
Appropriations Received	2,867	2,822
Appropriations Transferred In/Out	(2)	0
Other Adjustments	7	(115)
Appropriations Used	(3,125)	(3,039)
Total Budgetary Financing Sources	**(253)**	**(332)**
Total Unexpended Appropriations	**4,535**	**4,788**
Net Position	**$ 3,804**	**$ 4,723**

The accompanying notes are an integral part of these statements.

DEPARTMENT OF AGRICULTURE
RURAL DEVELOPMENT
COMBINED STATEMENT OF BUDGETARY RESOURCES
FOR THE YEARS ENDED SEPTEMBER 30, 2008 AND 2007
(In Millions)

	2008		2007	
	Budgetary	**Non-Budgetary Credit Program Financing Accts.**	**Budgetary**	**Non-Budgetary Credit Program Financing Accts.**
Budgetary Resources:				
Unobligated Balance brought forward, Oct. 1	$ 1,183	$ 1,247	$ 1,818	$ 1,305
Recoveries of Prior Year Unpaid Obligations	171	1,119	169	1,346
Budget Authority				
Appropriation	3,669	0	2,822	0
Borrowing Authority (Notes 16 & 17)	0	12,711	0	10,846
Spending Authority from Offsetting Collections:				
Earned				
Collected	4,374	6,107	4,797	5,983
Change in Receivables from Federal Sources	(21)	0	(44)	0
Change in Unfilled Customer Orders				
Without Advance from Federal Sources	0	48	0	7
Nonexpenditure Transfers, Net, Anticipated & Actual	119	0	14	0
Permanently Not Available	(3,456)	(4,237)	(4,086)	(5,902)
Total Budgetary Resources	**$ 6,039**	**$ 16,995**	**$ 5,490**	**$ 13,585**
Status of Budgetary Resources:				
Obligations Incurred: (Note 15)				
Direct	$ 3,700	$ 15,066	$ 3,790	$ 12,338
Reimbursable	512	0	517	0
Unobligated Balance:				
Apportioned	1,234	1,057	427	438
Unobligated Balance Not Available	593	872	756	809
Total Status of Budgetary Resources	**$ 6,039**	**$ 16,995**	**$ 5,490**	**$ 13,585**
Change in Obligated Balance:				
Obligated Balance, Net				
Unpaid Obligations Brought Forward, Oct. 1	$ 5,410	$ 18,369	$ 5,724	$ 19,171
Uncollected Customer Payments from Federal Sources, Brought Forward, Oct. 1	(29)	(641)	(73)	(634)
Total Unpaid Obligated Balance, Net	**5,381**	**17,728**	**5,651**	**18,537**
Obligations Incurred, Net	4,212	15,066	4,307	12,338
Gross Outlays	(4,528)	(11,269)	(4,452)	(11,794)
Recoveries of Prior Year Unpaid Obligations	(171)	(1,119)	(169)	(1,346)
Change in Uncollected Customer Payments from Federal Sources	21	(48)	44	(7)
Obligated Balance, Net, End of Period:				
Unpaid Obligations (Note 21)	4,923	21,046	5,410	18,369
Uncollected Customer Payments from Federal Sources	(8)	(688)	(29)	(641)
Total Unpaid Obligated Balance, Net, End of Period	**$ 4,915**	**$ 20,358**	**$ 5,381**	**$ 17,728**
Net Outlays				
Gross Outlays	$ 4,528	$ 11,269	$ 4,452	$ 11,794
Offsetting Collections	(4,374)	(6,107)	(4,797)	(5,983)
Distributed Offsetting Receipts	(493)	0	(488)	0
Total Net Outlays	**$ (339)**	**$ 5,162**	**$ (833)**	**$ 5,811**

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

The accompanying notes are an integral part of these statements.

RURAL DEVELOPMENT

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

AS OF SEPTEMBER 30, 2008 AND 2007

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the United States Department of Agriculture (USDA) Rural Development mission area. The financial statements have been prepared from the books and records in accordance with the Office of Management and Budget (OMB) *Circular A-136, Financial Reporting Requirements.*

B. Reporting Entity

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

With the passage of the 2006 Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriation Act, Public Law No. 109-97, the legal restriction on redeeming Government-owned Class A stock was removed. As a result of this change, the process of liquidation and dissolution of the Rural Telephone Bank (RTB) began. During FY 2008, RTB was dissolved in its entirety and will no longer be a reportable entity in future years. RTB is reported as part of the rural utilities program and included in Rural Development's mission area financial statements.

C. Basis of Accounting

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

Credit Reform Act of 1990 contained in the Omnibus Budget Reconciliation Act of 1990 are also applied.

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

All significant interfund and intrafund balances and transactions have been eliminated in the consolidation except for those Credit Reform transactions impacting the Statement of Budgetary Resources and Reconciliations of Net Cost of Operations to Budget **(Note 24)**.

During FY 2008, no new Statement of Federal Financial Accounting Standards (SFFAS) were implemented, as none were applicable or material.

D. Estimates

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

E. Revenue and Other Financing Sources

Revolving/Credit Funds:

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

General Funds:

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

F. Fund Balance with Treasury

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

G. Escrow Disbursement Account

With the implementation of the Centralized Servicing Center on October 1, 1996, Rural Development began collecting escrow payments (i.e., insurance and taxes) from new single family housing borrowers. Existing borrowers, which are delinquent and require servicing actions, must also submit escrow payments. The escrow payments are deposited with the Trustee, U.S. Bank. The Trustee is required to invest and disburse these funds as stipulated in the Trust Agreement. As of September 30, 2008 and 2007, the balance in this account was $125 and $109 million, respectively. This amount has been included in the Consolidated Balance Sheet on the Cash and Other Monetary Assets line and the related footnote **(Note 4)**. It has also been included on the Non-Entity Assets **(Note 2)** and Other Liabilities **(Note 11).**

H. Lending Activities

Direct loans are made by appropriated authority. These loans represent actual cash disbursements to borrowers which require repayment.

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

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

I. Loans Receivable and Related Foreclosed Property, Net

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

In an effort to more accurately portray the actual value of assets, Rural Development has adopted the USDA policy of writing off, for financial reporting purposes, all loans that are two years or more delinquent.

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

J. Property, Plant and Equipment

The land, buildings, and equipment in the current operating environment are provided by the General Services Administration, who charges a Standard Level Users Charge that approximates the commercial rental rates for similar properties. Under Credit Reform, all equipment purchases are made through the Salaries and Expense fund.

Costs of Internal Use Software are accounted for in accordance with SFFAS No. 10, Accounting for Internal Use Software. SFFAS No. 10 requires the capitalization of the cost of Internal Use Software whether it is commercial off-the-shelf, contractor-developed, or internally-developed which solely meets internal or operational needs.

Internal Use Software is classified as “general property, plant and equipment” as defined in SFFAS No. 6, Accounting for Property, Plant and Equipment. See **Note 7** for further information.

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

K. Liabilities

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

L. Borrowings/Interest Payable to Treasury

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

M. Pension and Other Employee Benefits

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

N. Resources Payable to Treasury

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

O. Contingencies

The Rural Development mission area is a party in various legal actions and claims through the normal course of its operations. In the opinion of management and the USDA Office of the General Counsel, the ultimate resolution of these legal actions and claims will not materially affect the financial position or results of operations **(Note 12)**.

P. Unexpended Appropriations

Unexpended appropriations include the undelivered orders and unobligated balances of the general funds and the program accounts which receive Congressional appropriations through the budgetary process. As appropriated funds incur obligations, the obligated amount is recorded as an undelivered order **(Note 21)**. Undelivered orders are reduced by either an expenditure or an obligation cancellation. Appropriated funds which are not obligated are treated as unobligated amounts. At the end of the fiscal year, certain multi-year appropriations which have unobligated balances remain available for obligation in future periods. Unobligated appropriations are returned to Treasury when their period of availability expires.

Q. Intragovernmental Financial Activities

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

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

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

R. Allocation Transfers

Rural Development is a party to allocation transfers with other federal agencies as both a transferring entity and a receiving entity. Allocation transfers are legal delegations by one department of its authority to obligate budget authority and outlay funds to another department. A separate fund account is created in the U.S. Treasury as a subset for tracking and reporting purposes. All allocation transfers of balances are credited to this account, and subsequent obligations and outlays incurred by the child entity are charged to this allocation account as they execute the delegated activity on behalf of the parent entity. All financial activity related to allocation transfers is reported in the financial statements of the parent entity, from which the underlying legislative authority, appropriations and budget apportionments are derived. Rural Development allocates funds, as the parent, to the Small Business Administration and Department of Housing and

Urban Development. Rural Development receives allocation transfers, as the child, from the Economic Development Administration, Appalachian Regional Commission, and Delta Regional Authority.

NOTE 2: NON-ENTITY ASSETS

Amounts are presented in millions.

	FY 2008		FY 2007	
With the Public				
Cash and Other Monetary Assets	$	125	$	109
Total Non-Entity Assets		125		109
Total Entity Assets		78,551		76,252
Total Assets	**$**	**78,676**	**$**	**76,361**

See **Note 1G** for a description of Cash and Other Monetary Assets. Non-Entity Assets represent assets that are **"not for use"** by Rural Development.

NOTE 3: FUND BALANCE WITH TREASURY

Amounts are presented in millions.

	FY 2008	FY 2007
Fund Balances:		
Revolving Funds	$ 3,586	**$** 2,441
General Funds	5,131	5,338
Other Fund Types	0	(1)
Total	**$ 8,717**	$ **7,778**
Status of Fund Balance with Treasury: (FBWT)		
Unobligated Balance:		
Available	$ 2,291	**$** 865
Unavailable	1,464	1,565
Obligated Balance Not Yet Disbursed	25,275	23,110
Clearing Account Balances	0	1
Borrowing Authority Not Yet Converted to Fund Balance	(20,079)	(17,481)
Authority Granted Prior to Credit Reform for Rental Assistance Grants	(234)	(282)
Total	**$ 8,717**	$ **7,778**

Fund balance with Treasury represents the undisbursed account balances with Treasury as reported in the mission area’s records.

Included in the Unavailable line are restricted funds which are limited in their future use and are not apportioned for current use. These amounts represent the expired authority in fixed-year Grant and Program accounts (fixed years prior to FY 2008) and are only available for restoration of funds. After the fifth year of expiration, all funds are returned to Treasury as required except those entities having extended authority. For FY’s 2008 and 2007, there were approximately $62 million and $58 million in expired funds, respectively.

Total unobligated balances and obligated balances not yet disbursed do not agree with the corresponding fund balance with Treasury amounts presented above, because Rural Development borrows funds from Treasury at the time certain obligations are disbursed. Borrowing authority not yet converted to fund balance represents unobligated and obligated amounts recorded at fiscal yearend, which will be funded by future borrowings.

NOTE 4: CASH AND OTHER MONETARY ASSETS

Amounts are presented in millions.

	FY 2008		FY 2007
Cash	$ 125		$ 109
Total Cash and Other Monetary Assets	**$ 125**		**$ 109**

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

NOTE 5: ACCOUNTS RECEIVABLE (A/R), NET

Amounts are presented in millions.

	FY 2008				
	Accounts Receivable, Gross		**Allowance for Uncollectible Accounts**		**Accounts Receivable, Net**
Intragovernmental					
A/R Revenue, Refund, Reimbursements	$ 0		$ 0		$ 0
Total Intragovernmental Accounts Receivable	**0**		**0**		**0**
With the Public					
Audit Receivable	4		3		1
Total Accounts Receivable	**$ 4**		**$ 3**		**$ 1**

	FY 2007				
	Accounts Receivable, Gross		**Allowance for Uncollectible Accounts**		**Accounts Receivable, Net**
Intragovernmental					
A/R Revenue, Refund, Reimbursements	$ 1		$ 0		$ 1
Total Intragovernmental Accounts Receivable	**1**		**0**		**1**
With the Public					
Audit Receivable	2		2		0
Total Accounts Receivable	**$ 3**		**$ 2**		**$ 1**

NOTE 6: LOANS RECEIVABLE AND RELATED FORECLOSED PROPERTY, NET

Balance Sheet Review

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

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

Direct Loans

Loans receivable and related foreclosed property, net balances at the end of FY 2008 were $70 billion compared to $68 billion at the end of FY 2007. Defaulted guaranteed programs were $126 million and $113 million at the end of FY's 2008 and 2007, respectively. Table 1 below illustrates the overall composition of the Rural Development loan portfolio by mission area and loan program for FY 2008 and FY 2007. Direct loan obligations or loan guarantee commitments made pre-1992 and the resulting direct loans or loan guarantees are reported at net present value. The provision calculation is based upon the weighted-average subsidy rate of the financing account cohorts.

During the fiscal year, the gross outstanding balance of the direct loans obligated post-1991 is adjusted by the value of the subsidy cost allowance held against those loans. Current year subsidy expense, modifications, and reestimates all contribute to the change of the subsidy cost allowance throughout the year. The subsidy cost allowance moved from $2.7 billion to $3.6 billion during FY 2008, an increase of $.9 billion. Table 2 shows the reconciliation of subsidy cost allowance balances from FY 2007 to FY 2008.

For post-1991 loans, the largest material fluctuation in the subsidy cost allowance in relation to the portfolio for FY 2008 compared to FY 2007 was experienced by the telecommunications program, with an overall allowance decline as the portfolio increased. Direct loan subsidy expense is a component of the subsidy cost allowance. The total direct loan subsidy expense for FY 2008 is a combination of subsidy expense for new direct loans disbursed in the current year, modifications to existing loans, and interest rate and technical reestimates to existing loans. Total direct loan subsidy expense in FY 2008 was $1,241 million compared to $55 million in FY 2007, an increase of $1,186 million. The changes are predominately due to reestimates in the new direct loan model for the non-housing programs. The programs include electric, telecommunications, and water/environmental. The housing programs also experienced a reestimate increase. Table 3 illustrates the breakdown of total subsidy expense, including reestimates, for FY's 2008 and 2007 by program.

Direct loan volume increased from $7.2 billion in FY 2007 to $7.4 billion in FY 2008. Volume distribution between programs is shown in Table 4. The electric loan disbursements accounted for the large increase in FY 2008.

Table 1

Total Credit Program Receivables and Related Foreclosed Property *(in millions)*					
FY 2008	**Loans Receivable, Gross**	**Interest Receivable**	**Foreclosed Property**	**Present Value Allowance**	**Value of Assets**
Direct Loans					
Obligated Pre-1992					
Housing Loans	$ 10,321	$ 109	$ 33	$ (4,866)	$ 5,597
Electric Loans	8,274	6	0	(1,689)	6,591
Telecommunications Loans	893	2	0	(54)	841
Rural Development *	1,470	15	0	(173)	1,312
Development Loan Funds	38	0	0	(18)	20
Other Programs	2	0	0	0	2
Pre-1992 Total	**20,998**	**132**	**33**	**(6,800)**	**14,363**
Obligated Post-1991					
Housing Loans	14,385	71	34	(2,316)	12,174
Community Facility Loans	2,658	27	0	(71)	2,614
Electric Loans	29,216	28	0	(336)	28,908
Telecommunications Loans	3,151	2	0	187	3,340
Water and Environmental Loans	8,583	87	0	(829)	7,841
Development Loan Funds	430	2	0	(163)	269
Business & Industry Funds	35	0	0	(24)	11
Economic Development	100	0	0	(13)	87
Post-1991 Total	**58,558**	**217**	**34**	**(3,565)**	**55,244**
Total Direct Loan Receivables	**79,556**	**349**	**67**	**(10,365)**	**69,607**
Defaulted Guaranteed Loans					
Pre-1992					
Rural Development Insurance Fund	3	0	0	0	3
Post-1991					
Community Facilities	0	0	0	0	0
Business and Industry	104	2	0	(10)	96
Housing Loans	60	0	0	(33)	27
Total Defaulted Guaranteed Loans	**$ 167**	**$ 2**	**$ 0**	**$ (43)**	**$ 126**
Total Loans Receivable and Related Foreclosed Property, Net					**$ 69,733**

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

Total Credit Program Receivables and Related Foreclosed Property *(in millions)*					
FY 2007	**Loans Receivable, Gross**	**Interest Receivable**	**Foreclosed Property**	**Present Value Allowance**	**Value of Assets**
Direct Loans					
Obligated Pre-1992					
Housing Loans	$ 10,845	$ 116	$ 21	$ (5,028)	$ 5,954
Electric Loans	10,045	88	0	(1,373)	8,760
Telecommunications Loans	1,047	3	0	(24)	1,026
Rural Development *	1,608	13	0	(195)	1,426
Development Loan Funds	41	0	0	(19)	22
Other Programs	3	0	0	0	3
Pre-1992 Total	**23,589**	**220**	**21**	**(6,639)**	**17,191**
Obligated Post-1991					
Housing Loans	13,680	60	23	(2,007)	11,756
Community Facility Loans	2,342	21	0	(82)	2,281
Electric Loans	26,006	170	0	(42)	26,134
Telecommunications Loans	2,936	6	0	327	3,269
Water and Environmental Loans	7,839	70	0	(638)	7,271
Development Loan Funds	419	2	0	(160)	261
Business & Industry Funds	51	0	0	(38)	13
Economic Development	91	0	0	(8)	83
Post-1991 Total	**53,364**	**329**	**23**	**(2,648)**	**51,068**
Total Direct Loan Receivables	**76,953**	**549**	**44**	**(9,287)**	**68,259**
Defaulted Guaranteed Loans					
Pre-1992					
Rural Development Insurance Fund	2	1	0	0	3
Post-1991					
Community Facilities	0	0	0	0	0
Business and Industry	118	3	0	(12)	109
Housing Loans	23	0	0	(22)	1
Total Defaulted Guaranteed Loans	**$ 143**	**$ 4**	**$ 0**	**$ (34)**	**$ 113**
Total Loans Receivable and Related Foreclosed Property, Net					**$68,372**

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

Table 2

Schedule for Reconciling Subsidy Cost Allowance Balances (Post-1991 Direct Loans) *(in millions)*					
Beginning Balance, Changes, and Ending Balance		**FY 2008**			**FY 2007**
Beginning Balance of the subsidy cost allowance		$ 2,682			$ 3,177
Add:	Subsidy expense for direct loans disbursed during the year by component				
	Interest rate differential costs	(51)			(83)
	Default costs (net of recoveries)	79			69
	Fees and other collections	(2)			(3)
	Other subsidy costs	235			292
	Total of the above subsidy expense components	261			275
Adjustments					
	Loan modifications	4			(3)
	Fees received	35			29
	Loans written off	(154)			(225)
	Subsidy allowance amortization	(289)			(380)
	Other	93			26
	Ending balance of the subsidy cost allowance before reestimates	2,632			2,899
Add or subtract subsidy reestimates by component					
	Interest rate reestimates	817			105
	Technical/default reestimate	159			(322)
	Total of the above reestimate components	976			(217)
Ending balance of the subsidy cost allowance		**$ 3,608**			**$ 2,682**

Table 3

Direct Loan Subsidy by Program and Component *(in millions)*										
FY 2008	**Subsidy Expense for New Direct Loans Disbursed**						**Reestimates**			
	Interest Differ-ential	**Defaults**	**Fees and Other Colls.**	**Other**	**Total**	**Total Modifi-cations**	**Interest Rate**	**Technical**	**Total**	**GRAND TOTAL**
Direct Loan Programs										
Housing Loans	$ (142)	$ 65	$ (2)	$ 248	$ 169	$ 4	$ 184	$ (51)	$ 133	**$ 306**
Community Facility Loans	19	1	0	(3)	17	0	0	0	0	**17**
Electric Loans	(32)	11	0	(6)	(27)	0	335	154	489	**462**
Telecommunications Loans	(1)	1	0	0	0	0	211	(19)	192	**192**
Water and Environmental Loans	86	1	0	(4)	83	0	94	63	157	**240**
Development Loan Funds	13	0	0	0	13	0	(7)	8	1	**14**
Business & Industry Funds	0	0	0	0	0	0	0	0	0	**0**
Economic Development	6	0	0	0	6	0	0	4	4	**10**
Total Subsidy Expense, Direct Loans	**$ (51)**	**$ 79**	**$ (2)**	**$ 235**	**$ 261**	**$ 4**	**$ 817**	**$ 159**	**$ 976**	**$ 1,241**

Direct Loan Subsidy by Program and Component *(in millions)*										
FY 2007	**Subsidy Expense for New Direct Loans Disbursed**					**Modifications and Reestimates**				
	Interest Differ-ential	**Defaults**	**Fees and Other Colls.**	**Other**	**Total**	**Total Modifi-cations**	**Interest Rate**	**Technical**	**Total**	**GRAND TOTAL**
Direct Loan Programs										
Housing Loans	$ (170)	$ 60	$ (3)	$ 308	$ 195	$ 1	$ (106)	$ 3	$(103)	**$ 93**
Community Facility Loans	17	1	0	(2)	16	0	31	(3)	28	**44**
Electric Loans	(26)	5	0	(10)	(31)	(4)	122	(108)	14	**(21)**
Telecommunications Loans	1	2	0	0	3	0	16	(124)	(108)	**(105)**
Water and Environmental Loans	75	1	0	(3)	73	0	31	(66)	(35)	**38**
Development Loan Funds	16	0	0	0	16	0	5	(6)	(1)	**15**
Business & Industry Funds	0	0	0	0	0	0	0	(14)	(14)	**(14)**
Economic Development	4	0	0	(1)	3	0	6	(4)	2	**5**
Total Subsidy Expense, Direct Loans	**$ (83)**	**$ 69**	**$ (3)**	**$ 292**	**$ 275**	**$ (3)**	**$ 105**	**$ (322)**	**$(217)**	**$ 55**

Table 4

Total Amount of Direct Loans Disbursed (Post-1991) *(in millions)*			
Direct Loans	**FY 2008**	**FY 2007**	**FY 2008 Over (Under) FY 2007**
Housing Loans	$ 1,316	$ 1,405	$ (89)
Community Facility Loans	434	451	(17)
Electric Loans	4,047	3,814	233
Telecommunications Loans	551	504	47
Water and Environmental Loans	1,018	969	49
Development Loan Funds	29	37	(8)
Business & Industry Loans	0	0	0
Economic Development	26	17	9
Total Direct Loans Disbursed	**$ 7,421**	**$ 7,197**	**$ 224**

Guaranteed Loans

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

Guaranteed loans outstanding at the end of FY 2008 increased compared to the FY 2007 portfolio. At the end of FY 2008 and FY 2007, there were $26.7 billion and $22.0 billion in outstanding principal (face value) and $23.6 billion and $19.3 billion in outstanding principal (guaranteed), respectively. Table 5 shows the outstanding balances by loan program. The liability for loan guarantees and for guaranteed loans obligated prior to October 1, 1991, are reported at present value which is the same methodology used by the direct loan programs. The provision calculation is based upon future cash flows discounted at the average interest rate of the Treasury interest-bearing debt. The estimate is reported as an expense, and a corresponding accrual for estimated losses on loan guarantees is reported as a liability.

During the fiscal year, the value of the guaranteed loans is adjusted by the value of the loan guarantee liability held against those loans. For the post-1991 guarantees, current year subsidy expense and reestimates all contribute to the change of the loan guarantee liability through the year. The loan guarantee liability is a combination of the liability for losses on pre-1992 guarantees and post-1991 guarantees. The liability increased in FY 2008 by $109 million compared to FY 2007. Table 6a shows the loan guarantee liability while Table 6b shows the liability reconciliation for post-1991 guarantees.

Total guaranteed loan subsidy expense for FY 2008 is a combination of subsidy expense for new guaranteed loans disbursed in the current year and the interest rate and technical reestimates to existing loans. Total guaranteed loan subsidy expense in FY 2008 was $81 million compared to $138 million in FY 2007, a decrease of $57 million. This decrease was mainly due to the guaranteed business and industry program. Table 7 illustrates the breakdown of total subsidy expense for FY 2008 and FY 2007 by loan program.

Guaranteed loan volume (face value) increased from $4.2 billion in FY 2007 to $7.3 billion in FY 2008. The housing loan program experienced the largest increase. Volume distribution between programs is shown in Table 8.

Table 5

Loan Guarantees Outstanding

(in millions)

Guaranteed Loans	**Pre-1992 Outstanding Principal, Face Value**	**Post-1991 Outstanding Principal, Face Value**	**Total Outstanding Principal, Face Value**	**Pre-1992 Outstanding Principal, Guaranteed**	**Post-1991 Outstanding Principal, Guaranteed**	**Total Outstanding Principal, Guaranteed**
FY 2008						
Housing Loans	$ 3	$ 21,823	$ 21,826	$ 3	$ 19,641	$ 19,644
Community Facility Loans	2	691	693	1	629	630
Electric Loans	174	214	388	174	214	388
Business and Industry Loans	14	3,756	3,770	10	2,833	2,843
Water and Environmental	0	68	68	0	59	59
Other Programs	0	0	0	0	0	0
Total Guarantees Disbursed	**$ 193**	**$ 26,552**	**$ 26,745**	**$ 188**	**$ 23,376**	**$ 23,564**
FY 2007						
Housing Loans	$ 6	$ 17,212	$ 17,218	$ 6	$ 15,491	$ 15,497
Community Facility Loans	3	660	663	2	584	586
Electric Loans	184	218	402	184	218	402
Business and Industry Loans	14	3,668	3,682	10	2,727	2,737
Water and Environmental	0	37	37	0	30	30
Other Programs	0	0	0	0	0	0
Total Guarantees Disbursed	**$ 207**	**$ 21,795**	**$ 22,002**	**$ 202**	**$ 19,050**	**$ 19,252**

Table 6a

Liability for Loan Guarantees *(in millions)*						
	FY 2008			FY 2007		
	Liabilities for Losses on Pre-1992 Guarantees Present Value	Liabilities for Loan Guarantees on Post-1991 Guarantees Present Value	Total Liabilities for Loan Guarantees	Liabilities for Losses on Pre-1992 Guarantees Present Value	Liabilities for Loan Guarantees on Post-1991 Guarantees Present Value	Total Liabilities for Loan Guarantees
Liability for Loan Guarantees						
Housing Loans	$ 0	$ 741	$ 741	$ 0	$ 617	$ 617
Community Facility Loans	0	25	25	0	38	38
Electric Loans	0	0	0	0	0	0
Business and Industry Loans	1	290	291	1	292	293
Water and Environmental Loans	0	0	0	0	0	0
Other Programs	0	0	0	0	0	0
Total Liabilities for Loan Guarantees	**$ 1**	**$ 1,056**	**$ 1,057**	**$ 1**	**$ 947**	**$ 948**

Table 6b

Schedule for Reconciling Loan Guarantee Liability *(in millions)*			
Beginning Balance, Changes, and Ending Balance	**FY 2008**		**FY 2007**
Beginning Balance of the loan guarantee liability	$ 947		$ 952
Add: Subsidy expense for guaranteed loans disbursed during the year by component			
Interest supplement costs	14		12
Default costs (net of recoveries)	311		181
Fees and other collections	(180)		(102)
Other subsidy costs	0		0
Total of the above subsidy expense components	145		91
Adjustments:			
Loan guarantee modifications	0		0
Fees received	135		80
Interest supplements paid	(3)		(1)
Claim payments to lenders	(56)		(76)
Interest accumulation on the liability balance	61		(32)
Other	(109)		(114)
Ending balance of the loan guarantee liability before reestimates	1,120		900
Add or subtract subsidy reestimates by component:			
Interest rate reestimate	35		32
Technical/default reestimate	(99)		15
Total of the above reestimate components	(64)		47
Ending balance of the loan guarantee liability	**$ 1,056**		**$ 947**

Table 7

Guaranteed Loan Subsidy Expense by Program and Component *(in millions)*										
FY 2008	**Subsidy Expense for New Guaranteed Loans Disbursed**					**Modifications and Reestimates**				
	Interest Supplement	**Defaults**	**Fees and Other Colls.**	**Other**	**Total**	**Total Modifi-cations**	**Interest Rate**	**Technical**	**Total**	**GRAND TOTAL**
Guaranteed Loan Programs										
Housing Loans	14	221	(144)	0	91	0	(2)	(10)	(12)	**79**
Community Facility Loans	0	7	(1)	0	6	0	0	0	0	**6**
Electric Loans	0	0	0	0	0	0	0	0	0	**0**
Business & Industry Loans	0	83	(35)	0	48	0	37	(89)	(52)	**(4)**
Water & Environmental Loans	0	0	0	0	0	0	0	0	0	**0**
Total Subsidy Expense, Guaranteed Loans	**14**	**311**	**(180)**	**0**	**145**	**0**	**35**	**(99)**	**(64)**	**81**

Guaranteed Loan Subsidy Expense by Program and Component *(in millions)*										
FY 2007	**Subsidy Expense for New Guaranteed Loans Disbursed**					**Modifications and Reestimates**				
	Interest Supplement	**Defaults**	**Fees and Other Colls.**	**Other**	**Total**	**Total Modifi-cations**	**Interest Rate**	**Technical**	**Total**	**GRAND TOTAL**
Guaranteed Loan Programs										
Housing Loans	12	116	(78)	0	50	0	10	(27)	(17)	**33**
Community Facility Loans	0	10	(2)	0	8	0	2	2	4	**12**
Electric Loans	0	0	0	0	0	0	0	0	0	**0**
Business & Industry Loans	0	55	(22)	0	33	0	21	39	60	**93**
Water & Environmental Loans	0	0	0	0	0	0	(1)	1	0	**0**
Total Subsidy Expense, Guaranteed Loans	**12**	**181**	**(102)**	**0**	**91**	**0**	**32**	**15**	**47**	**138**

Table 8

Guaranteed Loans Disbursed *(in millions)*	**FY 2008**		**FY 2007**	
	Principal, Face Value Disbursed	**Principal, Guaranteed Disbursed**	**Principal, Face Value Disbursed**	**Principal, Guaranteed Disbursed**
Guaranteed Loans				
Housing Loans	$ 6,356	$ 5,721	$ 3,503	$ 3,152
Community Facility Loans	127	111	140	122
Electric Loans	0	0	0	0
Business and Industry Loans	781	609	588	459
Water and Environmental Loans	40	33	7	6
Total Guaranteed Loans Disbursed	**$ 7,304**	**$ 6,474**	**$ 4,238**	**$ 3,739**

Credit Program Discussion and Descriptions

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

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

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

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

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

Rural Development List of Programs

Rural Business-Cooperative Programs

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

Rural Housing Programs

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

Rural Utilities Programs

Electric Direct Loans
Electric Guaranteed Loans
Telecommunications Direct Loans
Water and Environmental Direct Loans
Water and Environmental Guaranteed Loans

Table 9a

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

Table 9b

Program Characteristics – Guaranteed			
Major Programs (Guaranteed)	**Repayment Period**	**Interest Rate**	**Unique Servicing Option**
Housing			
Single-Family	Maximum 30 years	Lender	Maximum 90% guarantee – Lender pays 2% fee – Loans may be sold to third party.
Rental Housing	Maximum 40 years	Lender	.5% annual fee is also charged.
Community Facilities	Maximum 40 years	Lender	Maximum 90% guarantee – Lender pays 1% fee – Loans may be sold to third party.
Electric	Maximum 35 years	Lender	100% Guarantee
Business and Industry	Maximum 7-30 years per program	Lender	Guarantee maximum 60-80% - Lender pays 2% fee and .25% annual fee.
Water and Environmental	Maximum 40 years	Lender	Rates will be negotiated between the lender and the borrower. They may be fixed or variable rates.

Discussion of Administrative Expenses, Subsidy Costs, and Subsidy Rates

Administrative Expenses

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

Table 10

Administrative Expenses (*in millions)*			
FY 2008			
Direct Loan Programs	**Amount**	**Guaranteed Loan Programs**	**Amount**
Total	**$ 233**		**$ 288**
FY 2007			
Direct Loan Programs	**Amount**	**Guaranteed Loan Programs**	**Amount**
Total	**$ 220**	***Total***	**$ 225**

Reestimates, Default Analysis, and Subsidy Rates

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

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

Rural Development's cash flow models are tailored for specific programs based on unique program characteristics. Specific models developed and utilized include models for housing, guaranteed, Electric Underwriters, FFB modifications, and a direct model that covers the remaining portfolio with similar characteristics. In FY 2008, reestimates for all FFB programs were recorded in accordance with the Office of Management and Budget (OMB) guidance that FFB debt associated with the loan programs be treated similar to Treasury Debt. In FY 2008 and FY 2007, reestimates using projected fiscal year activity were recorded in the current fiscal year.

In FY 2008 and FY 2007, Rural Development guaranteed loan programs recorded prior year actual budgetary reestimates and current year activity projected reestimates for material programs. A key sensitivity element in the guaranteed programs is defaults. Fees and other collections are significant in the guaranteed housing and business and industry programs.

An analysis was performed on the reestimates and subsidy rates for the direct and guaranteed programs. For FY 2008, a new credit reform cash flow model was developed for the direct loan programs (non-housing). The improvements made in the model resulted in upward reestimates for the programs. Two enhancements that generated the majority of the changes were the expanded amortization methodology and a correction to the adjustment for the difference between the expected and actual unpaid principal balance. Upward reestimates for the electric, telecommunications and water and environmental programs were $489 million, $192 million, and $157 million, respectively. In the electric program, the underwriters program contributed significantly to that program's increase.

Another methodology change occurred with the Federal Financing Bank's financed loans. The Office of Management and Budget, which provides oversight on the credit reform formulation and reestimate processes, recommended that the debt associated with the loan programs be treated similar to other Treasury financed debt. Therefore, those credit reform program yearend processes included earning additional interest on fund balances. Cash flow processes were modified to accommodate this change. The programs impacted include FFB Telephone, FFB Electric, Electric Underwriters, and loan extension modifications. In FY 2007, the pass through method was used for the FFB programs in accordance with OMB guidance. The pass through method recorded all FFB payments as other inflow and outflows and were not included in the interest calculations.

The Single Family Housing credit reform model was implemented during FY 2007, however, a satisfactory result was not accomplished by audit closure. During FY 2008, numerous meetings and reviews were performed on the model and reestimates performed. An upward reestimate resulted in an increase of $133 million subsidy expense, attributed primarily to decreases in future prepayment and interest credit recapture projections.

Table 7 indicates the guaranteed programs recorded a $64 million downward reestimate expense in the current period. The amount is insignificant to the portfolio as a whole and further discussion is unwarranted.

Subsidy rates are used to compute each year's subsidy expense as disclosed in Tables 3 and 7. The subsidy rates disclosed in Tables 11 and 12 pertain only to the FY 2008 cohorts. These rates cannot be applied to the direct and guaranteed loans disbursed during the current reporting year to yield the subsidy expense. The subsidy expense for loans reported in the current year could result from disbursements of loans from both current-year cohorts and prior-year cohorts. Table 11 has the direct loan subsidy rates for FY 2008 and FY 2007 and Table 12 has guaranteed program subsidy rates. The Water and Environmental loan program utilized two subsidy rates during FY 2008. New assumptions were provided and approved, which resulted in a subsidy rate of 14.2 percent primarily due to interest rates. The multi-family housing credit sales modified the overage percentage and calculated a 30-year balloon payment, resulting in a 37.14 percent subsidy rate. The Section 514 multi-family housing domestic farm labor program changed default and prepayment assumptions which provided a 43.26 FY 2008 subsidy percentage.

Modifications

A modification is any Government action different from the baseline assumptions that affects the subsidy cost, such as a change in the terms of the loan contract. The cost of a modification is the difference between the present value of the cash flows before and after the modification.

Multiple-family housing direct loan program modifications related to the revitalization project, which began in FY 2006, continued throughout FY 2008. The revitalization project is used to rehabilitate ailing housing developments. In this program, Rural Development determines whether the development owner should be offered a financial restructuring plan and what type of incentives, if any, should be offered to the owner to rehabilitate an ailing housing development and to provide affordable rent for tenants who live in such projects.

In FY 2007, loan extension modifications were granted for two borrowers in the FFB electric program. The maturity dates were extended up to 20 years on selected advances. Interest rates on the advances did not change. At the time of the modification, the liquidating fund was paid off and the advances were moved to the financing fund. The post-modification cash flows were discounted at the third quarter net present value discount factor from the FY 2007 President's Budget relative to the effective date of the loan extension modifications.

Table 11

Subsidy Rates for Direct Loans (Percentage)											
FY 2008						**FY 2007**					
	Interest Differential	Defaults	Fees and Other Colls.	Other	Total		Interest Differential	Defaults	Fees and Other Colls.	Other	Total
Direct Loan Programs						**Direct Loan Programs**					
Section 502 Single-Family Housing	-13.44	5.73	0.00	17.08	9.37	Section 502 Single-Family Housing	-14.99	5.37	0.00	19.65	10.03
Section 504 Housing Repair	29.14	0.94	0.00	-1.81	28.27	Section 504 Housing Repair	30.08	1.47	0.00	-2.00	29.55
Credit Sales Section 203 (SFH)	-15.38	7.85	0.00	6.38	-1.15	Credit Sales Section 203 (SFH)	-16.88	9.56	0.00	7.80	0.48
Section 514 Farm Labor Housing	44.45	8.93	0.00	-10.12	43.26	Section 514 Farm Labor Housing	45.52	0.21	0.00	2.22	47.95
Section 515 Rural Rental Housing	-17.92	1.13	0.00	59.40	42.61	Section 515 Rural Rental Housing	-18.32	0.07	0.00	63.92	45.67
Section 523 Self-Help Housing Land Development	2.84	0.00	0.00	0.00	2.84	Section 523 Self-Help Housing Land Development	2.47	0.00	0.00	0.00	2.47
Section 524 Housing Site Development	-1.71	0.92	0.00	0.00	-0.79	Section 524 Housing Site Development	-2.59	0.93	0.00	0.00	-1.66
Credit Sales Section 209 (MFH)	-17.41	5.41	0.00	49.14	37.14	Credit Sales Section 209 (MFH)	-19.19	0.11	0.00	64.41	45.33
Community Facilities	5.40	0.73	0.00	-0.58	5.55	Community Facilities	7.04	0.18	0.00	-0.81	6.41
Distance Learning and Telemedicine	0.00	2.15	0.00	-0.01	2.14	Distance Learning and Telemedicine	-0.72	1.35	0.00	0.00	0.63
Broadband	0.00	2.17	0.00	-0.02	2.15	Broadband	0.00	2.19	0.00	-0.04	2.15
Water & Environmental	7.03	0.09	0.00	-0.31	6.81	Water & Environmental	10.31	0.09	0.00	-0.44	9.96
Electric Hardship	-0.03	0.96	0.00	-0.81	0.12	Electric Hardship	2.25	0.00	0.00	-0.11	2.14
Electric Municipal	Not Funded					Electric Municipal	1.26	0.00	0.00	0.25	1.51
FFB Electric	-1.37	0.67	0.00	0.00	-0.70	FFB Electric	-1.21	0.02	0.00	0.00	-1.19
Electric Treasury	Not Funded					Electric Treasury	0.00	0.00	0.00	0.00	0.00
Telephone Hardship	-0.96	1.00	0.00	0.04	0.08	Telephone Hardship	0.36	0.01	0.00	0.00	0.37
Telephone Treasury	0.00	0.64	0.00	0.03	0.67	Telephone Treasury	0.00	0.03	0.00	0.00	0.03
FFB Telephone	-0.01	0.85	0.00	-0.22	0.62	FFB Telephone	-1.21	0.02	0.00	-0.30	-1.49
Intermediary Relending Program	43.53	0.00	0.00	-0.64	42.89	Intermediary Relending Program	44.93	0.00	0.00	-0.86	44.07
Rural Economic Development	23.15	0.21	0.00	-0.77	22.59	Rural Economic Development	23.45	0.18	0.00	-1.79	21.84
Electric Underwriters	-1.49	0.55	0.00	0.00	-0.94	Electric Underwriters	-1.24	0.81	0.00	0.00	-0.43
MFH Preservation Demo	46.39	0.00	0.00	0.00	46.39	MFH Preservation Demo	47.81	0.00	0.00	0.01	47.82

***Rate in effect 5/2008, 14.20%**

Table 12

Subsidy Rates for Loan Guarantees (Percentage)											
FY 2008						**FY 2007**					
	Interest Differential	Defaults	Fees and Other Colls.	Other	Total		Interest Differential	Defaults	Fees and Other Colls.	Other	Total
Guaranteed Loan Programs						**Guaranteed Loan Programs**					
Section 502 Single-Family Housing	0.00	3.20	-2.00	0.00	1.20	Section 502 Single-Family Housing	0.00	3.21	-2.00	0.00	1.21
Section 502 Single-Family Housing - Refinance	0.00	1.31	-0.50	0.00	0.81	Section 502 Single-Family Housing - Refinance	0.00	1.00	-0.50	0.00	0.50
Section 538 Multi-Family Housing	16.91	0.42	-7.94	0.01	9.40	Section 538 Multi-Family Housing	14.59	0.50	-7.35	0.00	7.74
Community Facilities	0.00	4.54	-0.86	0.00	3.68	Community Facilities	0.00	4.52	-0.86	0.00	3.66
Business and Industry	0.00	7.33	-3.01	0.00	4.32	Business and Industry	0.00	7.40	-3.04	0.00	4.36
NAD Bank	0.00	10.84	-3.14	-0.01	7.69	NAD Bank	Not Funded				
Water and Environmental	0.00	0.00	-0.82	0.00	-0.82	Water and Environmental	0.00	0.00	-0.90	0.00	-0.90
Renewable Energy	0.00	11.97	-2.28	0.00	9.69	Renewable Energy	0.00	8.03	-1.54	0.00	6.49

Other Disclosures

Foreclosed Property

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

For FY’s 2008 and 2007, rural housing program properties consisted primarily of 800 and 591 rural single-family dwellings, respectively. The average holding period for single-family housing properties in inventory for FY’s 2008 and 2007 was 17 months and 23 months, respectively. The approximate number of borrowers for which foreclosure proceedings were in process at the end of FY’s 2008 and 2007 was 7,100 and 7,300, respectively. Certain properties can be leased to eligible individuals.

Commitments to Guarantee

As of September 30, 2008 and 2007 there were approximately $3.5 billion and $2.4 billion in commitments to extend loan guarantees, respectively.

Non-performing Loans

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

Interest Credit

Approximately $17.7 billion and $17.8 billion of the rural housing programs unpaid loan principal as of September 30, 2008 and 2007, respectively, was receiving interest credit. If those loans receiving interest credit had interest accrued at the full-unreduced rate, interest income would have been approximately $947 million and $1.0 billion higher for FY's 2008 and 2007, respectively. At the end of FY's 2008 and 2007, the Rural Development housing portfolio contained approximately 73.3 thousand and 76.5 thousand restructured loans with an outstanding unpaid principal balance of $2.4 billion and $2.5 billion, respectively.

NOTE 7: GENERAL PROPERTY, PLANT AND EQUIPMENT, NET

Amounts are presented in millions.

This equipment generally represents computer hardware, software, and other office equipment used in the Rural Development mission area's network of offices. Refer to **Note 1J** for further information.

FY 2008						
Classes	**Cost**	**Accumulated Depreciation**	**Book Value**	**Estimated Useful Life***	**Method of Depreciation****	**Capitalization Threshold**
Personal Property						
Equipment	$ 3	$ 3	$ 0	5-20	SL	$ 25,000
Internal Use Software	97	44	53	5-8	SL	$ 100,000
Internal Use Software in Development	9	0	9	2-5	SL	$ 100,000
Total	**$ 109**	**$ 47**	**$ 62**			

FY 2007						
Classes	**Cost**	**Accumulated Depreciation**	**Book Value**	**Estimated Useful Life***	**Method of Depreciation****	**Capitalization Threshold**
Personal Property						
Equipment	$ 5	$ 4	$ 1	1-5	SL	$ 25,000
Internal Use Software	92	35	57	2-15	SL	$ 100,000
Internal Use Software in Development	7	0	7	2-15	SL	$ 100,000
Total	**$ 104**	**$ 39**	**$ 65**			

* Range of Service Life
** SL - Straight Line

NOTE 8: OTHER ASSETS

Amounts are presented in millions.

	FY 2008			FY 2007	
Intragovernmental					
Advances to Others	$	1		$	0
Total Intragovernmental	**$**	**1**		**$**	**0**
With the Public					
Investment in Loan Asset Sale Trust*	$	35		$	34
Other		2			2
Total Other Assets – Non-Governmental	**$**	**37**		**$**	**36**
Total Other Assets	**$**	**38**		**$**	**36**

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

NOTE 9: LIABILITIES NOT COVERED BY BUDGETARY RESOURCES

Amounts are presented in millions.

	FY 2008			FY 2007	
Intragovernmental					
Unfunded Federal Employees Compensation Act (FECA) Liability	$	6		$	6
Total Intragovernmental		**6**			**6**
With the Public					
Federal Employee and Veteran Benefits		31			28
Unfunded Annual Leave		38			37
Total Liabilities Not Covered by Budgetary Resources		75			71
Total Liabilities Covered by Budgetary Resources		74,797			71,567
Total Liabilities	**$**	**74,872**		**$**	**71,638**

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

NOTE 10: DEBT

Amounts are presented in millions.

	FY 2007 Beginning Balance	Net Borrowing	FY 2007 Ending Balance	Net Borrowing	FY 2008 Ending Balance
Intragovernmental Debt					
Debt to the Treasury	$ 33,829	$ 3,199	$ 37,028	**$** 3,019	**$** 40,047
Debt to the Federal Financing Bank (FFB)	25,259	644	25,903	473	26,376
Total Intragovernmental Debt	**$ 59,088**	**$ 3,843**	**$ 62,931**	**$ 3,492**	**$ 66,423**
Agency Debt					
Held by the Public	$ 0	$ 0	$ 0	$ 0	$ 0
Notes Payable	0	0	0	0	0
Total Agency Debt	**$ 0**	**$ 0**	**$ 0**	**$ 0**	**$ 0**
Total Debt	**$ 59,088**	**$ 3,843**	**$ 62,931**	**$ 3,492**	**$ 66,423**

	FY 2008	FY 2007
Classification of Debt		
Intragovernmental Debt	$ 66,423	$ 62,931
Debt Held by the Public	0	0
Total Debt	**$ 66,423**	**$ 62,931**

Borrowing from the Federal Financing Bank (FFB) is either in the form of Certificates of Beneficial Ownership (CBO) or loans executed directly between the borrower and FFB with Rural Development unconditionally guaranteeing repayment. CBO's outstanding with FFB are generally secured by unpaid loan principal balances. CBO's outstanding are related to Pre-Credit Reform loans and are no longer used for program financing. FFB CBO's are repaid as they mature and are not related to any particular group of loans.

Borrowings made to finance loans directly between the borrower and FFB mature and are repaid as the related group of loans become due. Interest rates on the related group of loans are equal to interest rates on FFB borrowings, except in those situations in which an FFB-funded loan is restructured and the terms of the loan are modified.

Supplemental information associated with debt follows:

Amounts are presented in millions.

	FY 2008		FY 2007
Interest Payable, Federal			
Federal Financing Bank	$ 50		$ 300
Treasury	0		0
Total	**$ 50**		**$ 300**

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

	FY 2008		FY 2007
Interest Expense, Federal			
Federal Financing Bank	$ 1,450		$ 1,791
Treasury	2,064		1,967
Total	**$ 3,514**		**$ 3,758**

NOTE 11: OTHER LIABILITIES

Amounts are presented in millions.

	FY 2008				
	Non-Current		**Current**		**Total**
Intragovernmental					
Employer Contributions & Payroll Taxes Payable	$ 0		$ 4		$ 4
Unfunded FECA Liability	0		6		6
Liability for Deposit Funds & Suspense Accounts	0		(3)		(3)
Other Accrued Liabilities	0		8		8
Payable to Treasury General Fund	0		1,012		1,012
Total Intragovernmental	**$ 0**		**$ 1,027**		**$ 1,027**
Accrued Funded Payroll and Leave	$ 0		$ 18		$ 18
Liability for Deposit Funds and Suspense Accounts	0		127		127
Unfunded Annual Leave	0		38		38
Other Accrued Liabilities	0		79		79
Other	20		(12)		8
Total Other Liabilities	**$ 20**		**$ 1,277**		**$ 1,297**

Amounts are presented in millions.

	FY 2007				
	Non-Current		**Current**		**Total**
Intragovernmental					
Employer Contributions & Payroll Taxes Payable	$ 0		$ 3		$ 3
Unfunded FECA Liability	0		6		6
Liability for Deposit Funds & Suspense Accounts	0		(2)		(2)
Other Accrued Liabilities	0		7		7
Payable to Treasury General Fund	0		1,306		1,306
Total Intragovernmental	**$ 0**		**$ 1,320**		**$ 1,320**
Accrued Funded Payroll and Leave	$ 0		$ 0		$ 0
Liability for Deposit Funds and Suspense Accounts	0		111		111
Unfunded Annual Leave	0		37		37
Other Accrued Liabilities	0		19		19
Other	19		(13)		6
Total Other Liabilities	**$ 19**		**$ 1,474**		**$ 1,493**

These liabilities are covered by Budgetary Resources.

Beginning with FY 2008, accrued grants payable are reflected as other accrued liabilities with the public. Prior to FY 2008, accrued grants payable were reflected as accounts payable with the public.

NOTE 12: COMMITMENTS AND CONTINGENCIES

COMMITMENTS

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

As of September 30, 2008 and 2007, there were approximately $3.5 billion and $2.4 billion in commitments to extend loan guarantees, respectively.

As of September 30, 2008 and 2007, there were no obligations due to cancelled appropriations for which there was a contractual commitment for payment.

CONTINGENCIES

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

In FY 2008, litigation is pending in a case which the outcome has been deemed reasonably possible. The case, which was reported in the FY 2007 footnotes, is a breach of contract case and determination has been made by the Office of General Counsel that it is reasonably possible that a $9 million unfavorable outcome could result.

Two breach of contract cases regarding Housing Section 515 loan prepayments have been deemed probable in FY 2008. As of September 30, 2008, legal counsel was unable to make an estimated amount or range of potential loss for both cases. For one of the two cases, it has subsequently been determined that a $3 million unfavorable outcome is likely. However, this determination was not made until November 7, 2008. Due to the timing and immateriality of this amount, it was not accrued in the financial statements.

Although overall the existing multi-family housing portfolio is in fair to good condition, Rural Development National Office officials have determined that adequate funds have not been accrued to address future maintenance costs. Adequate maintenance programs are necessary or properties and apartment units will physically deteriorate to the point where safety and sanitation will necessitate a general modernization program to maintain their marketability and ultimately compete for tenants. The cost is expected to reach into the hundreds of millions of dollars.

House Resolution 5039, the Saving America's Rural Housing Act of 2006, was enacted to resolve this problem. The Act enables Rural Development to offer borrowers a financial restructuring plan for the multi-family housing development which may include one or more revitalization benefits.

NOTE 13: SUPPORTING SCHEDULE FOR THE STATEMENT OF NET COST

Amounts are presented in millions.

	FY 2008				
	Mortgage Credit	**Housing Assistance**	**Area & Regional Development**	**Energy Supply & Conservation**	**Consolidated Total**
Intragovernmental Gross Costs:					
Borrowing Interest Expense	$ 672	$ 3	$ 668	$ 2,171	$ 3,514
Other	207	25	86	26	344
Total Intragovernmental Gross Cost	**879**	**28**	**754**	**2,197**	**3,858**
Less: Intragovernmental Earned Revenue **(Note 14)**	98	3	81	178	360
Intragovernmental Net Costs	**781**	**25**	**673**	**2,019**	**3,498**
Gross Costs with the Public:					
Grants	0	1,019	776	0	1,795
Loan Cost Subsidies	372	14	288	648	1,322
Other	225	40	178	798	1,241
Total Gross Costs with the Public	**597**	**1,073**	**1,242**	**1,446**	**4,358**
Less: Earned Revenues from the Public **(Note 14)**	1,065	3	748	2,367	4,183
Net Costs with the Public	**(468)**	**1,070**	**494**	**(921)**	**175**
Net Cost of Operations	**$ 313**	**$ 1,095**	**$ 1,167**	**$ 1,098**	**$ 3,673**

Amounts are presented in millions.

	FY 2007								
	Mortgage Credit		**Housing Assistance**		**Area & Regional Development**		**Energy Supply & Conservation**		**Consolidated Total**
Intragovernmental Gross Costs:									
Borrowing Interest Expense	$ 668		$ 1		$ 636		$ 2,453		$ 3,758
Other	237		21		78		26		362
Total Intragovernmental Gross Cost	**905**		**22**		**714**		**2,479**		**4,120**
Less: Intragovernmental Earned Revenue **(Note 14)**	107		1		109		97		314
Intragovernmental Net Costs	**798**		**21**		**605**		**2,382**		**3,806**
Gross Costs with the Public:									
Grants	2		982		752		0		1,736
Loan Cost Subsidies	111		14		135		(67)		193
Other	301		29		219		82		631
Total Gross Costs with the Public	**414**		**1,025**		**1,106**		**15**		**2,560**
Less: Earned Revenues from the Public **(Note 14)**	1,121		0		776		2,533		4,430
Net Costs with the Public	**(707)**		**1,025**		**330**		**(2,518)**		**(1,870)**
Net Cost of Operations	**$ 91**		**$ 1,046**		**$ 935**		**$ (136)**		**$ 1,936**

OTHER DISCLOSURES

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

USDA and the individual agencies preparing their own financial statements are required to prepare the Statement of Net Cost at the subfunction level. The Statement of Net Cost, as prepared by Treasury, shows these activities at their function level.

NOTE 14: EARNED REVENUES

Amounts are presented in millions.

	FY 2008													
	Mortgage Credit			Housing Assistance			Area & Regional Development			Energy Supply & Conservation			Total	
Intragovernmental														
Interest Revenue from Treasury	$	89		$	2		$	77		$	177		$	345
Other		9			1			4			1			15
Total		**98**			**3**			**81**			**178**			**360**
With the Public														
Interest Revenue		1,059			2			735			2,367			4,163
Other		6			1			13			0			20
Total		**1,065**			**3**			**748**			**2,367**			**4,183**
Total Earned Revenues	**$**	**1,163**		**$**	**6**		**$**	**829**		**$**	**2,545**		**$**	**4,543**

	FY 2007													
	Mortgage Credit			Housing Assistance			Area & Regional Development			Energy Supply & Conservation			Total	
Intragovernmental														
Interest Revenue from Treasury	$	97		$	0		$	106		$	96		$	299
Other		10			1			3			1			15
Total		**107**			**1**			**109**			**97**			**314**
With the Public														
Interest Revenue		1,113			0			770			2,533			4,416
Other		8			0			6			0			14
Total		**1,121**			**0**			**776**			**2,533**			**4,430**
Total Earned Revenues	**$**	**1,228**		**$**	**1**		**$**	**885**		**$**	**2,630**		**$**	**4,744**

Other Disclosures

Credit Reform

The amount of subsidy expense on post-1991 direct loans equals the present value of estimated cash outflows over the life of the loan less the present value of cash inflows, discounted at the interest rate of marketable Treasury securities within a similar maturity term. A major component of subsidy expense is the interest subsidy cost/interest differential. This is defined as the excess of the amount of direct loans disbursed over the present value of the interest and principal payments required by the loan contracts, discounted at the applicable Treasury rate. One of the components of interest subsidy cost/interest differential is interest revenue. This interest revenue is earned from both Federal and non-Federal sources. For a further discussion of present value refer to **Note 1l** and **Note 6**.

Exchange Transactions With Non-Federal Sources

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

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

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

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

Exchange Transactions with Federal Sources

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

NOTE 15: APPORTIONMENT CATEGORIES OF OBLIGATIONS INCURRED

Amounts are presented in millions.

	FY 2008				
	Direct		**Reimbursable**		**Total**
Category A	$ 0		$ 0		$ 0
Category B	18,766		512		19,278
Total Obligations Incurred	**$ 18,766**		**$ 512**		**$ 19,278**

	FY 2007				
	Direct		**Reimbursable**		**Total**
Category A	$ 8,729		$ 0		$ 8,729
Category B	7,399		517		7,916
Total Obligations Incurred	**$ 16,128**		**$ 517**		**$ 16,645**

Due to the late approvals of SF132 Apportionment Schedules, the Budget Office will no longer Apportion funds in Category A. This change was discussed with OMB and they had no objections to the change.

NOTE 16: AVAILABLE BORROWING AUTHORITY, END OF PERIOD

As of September 30, 2008 and 2007, the amount of available borrowing authority was $20.1 billion and $17.5 billion, respectively.

NOTE 17: TERMS OF BORROWING AUTHORITY USED

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

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

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

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

NOTE 18: PERMANENT INDEFINITE APPROPRIATIONS

Existence, purpose, and availability of permanent indefinite appropriations: Permanent indefinite appropriations are mainly applicable to liquidating accounts which have the ability for apportionment and the program accounts for reestimates related to upward adjustments of subsidy. These appropriations become available pursuant to standing provisions of law without further action by

Congress after transmittal of the Budget for the year involved. They are treated as permanent the first year they become available, as well as in succeeding years. However, they are not stated as specific amounts but are determined by specified variable factors, such as "cash needs" for the liquidating accounts, and for the program accounts by information about the actual performance of a cohort or estimated changes in future cash flows of the cohort.

The period of availability for these appropriations are as follows: (1) Annual authority is available for obligation only during a specified year and expires at the end of that time; (2) Multi-year authority is available for obligation for a specified period of time in excess of one fiscal year; (3) No-year authority remains available for obligation for an indefinite period of time, usually until the objectives for which the authority was made available are achieved.

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

NOTE 19: LEGAL ARRANGEMENTS AFFECTING USE OF UNOBLIGATED BALANCES

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

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

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

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

The time limitations on the use of unobligated balances are the same as those previously discussed in the last two paragraphs of the permanent indefinite appropriations footnote disclosure **(Note 18).**

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

NOTE 20: EXPLANATION OF DIFFERENCES BETWEEN THE STATEMENT OF BUDGETARY RESOURCES (SBR) AND THE BUDGET OF THE UNITED STATES GOVERNMENT

The 2010 Budget of the United States Government, with the Actual Column completed for FY 2008, has not yet been published as of the date of these financial statements. The Budget is currently expected to be published and delivered to Congress in early February 2009. The Budget will be available from the Government Printing Office.

The 2009 Budget of the United States Government, with the Actual Columns completed for FY 2007, was published in February 2008 and reconciled to the SBR. Reconciling items were noted as described in the table below. The reconciling items represent:

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

- In FY 2007, Total Net Outlays on the SBR reflect an accounting reduction for Distributed Offsetting Receipts. Also in FY 2007, OMB Circular A-136 required including certain clearing accounts and miscellaneous receipt accounts on the Distributed Offsetting Receipts line.

- Amounts due to rounding.

Reconciliation Between FY 2007 Statement of Budgetary Resources and the President's Budget

Amounts are presented in millions.

Applicable Line From SBR	Amount from SBR	Applicable Line From President's Budget	Amount From President's Budget	Legitimate Differences	Reporting Errors
Total Budgetary Resources (Line 7)	$19,075	Total budgetary resources available for obligation	$ 18,964	$ 111 E - 113 R - (2)	None
Obligations Incurred (Line 8)	$16,645	Total new obligations	$ 16,620	$ 25 E - 25 R - 0	None
Distributed Offsetting Receipts (Line 19C)	$ (488)	Treasury Combined Statement (Receipts by Department)	$ (486)	$ (2) A - (2) R - 0	None
Total Net Outlays (Line 19D)	$ 4,978	Outlays	$ 5,465	$ (487) A- (2) O - (486) R - 1	None

LEGEND

A = Adjustment
E = Expired Budgetary Authority
O = Distributed Offsetting Receipts
R = Rounding

NOTE 21: UNDELIVERED ORDERS AT THE END OF THE PERIOD

As of September 30, 2008 and 2007, the amount of undelivered orders was $25.8 billion and $23.4 billion, respectively. The remaining amount as presented on the financial statement line is attributed to delivered orders.

NOTE 22: ADJUSTMENTS TO BEGINNING BALANCE OF BUDGETARY RESOURCES

Amounts are presented in millions.

	FY 2008 Obligated		FY 2007 Obligated
Beginning Balances	$ 23,109		$ 24,189
Adjustments	0		(1)
Beginning Balances, as adjusted	**$ 23,109**		**$ 24,188**

An adjustment to the beginning balance of budgetary resources obligated balance occurred as a result of a change in reporting requirements effective FY 2007 for allocation transfers. Beginning in FY 2007, child activity is reported in the financial statements of the parent entity. Prior to FY 2007, Rural Development had reported child activity in the financial statements.

NOTE 23: INCIDENTAL CUSTODIAL COLLECTIONS

Amounts are presented in millions.

	Custodial Activity	
	FY 2008	**FY 2007**
Sources of Collections		
Natural Resources Conservation Service Loan Collections	$ 2	$ 2
Total Revenue Collected	**$ 2**	**$ 2**
Disposition of Collections		
Amount Transferred to Treasury Receipt Accounts	$ 2	$ 2
Total Disposition of Revenue	**$ 2**	**$ 2**
Net Custodial Activity	**$ 0**	**$ 0**

NOTE 24: RECONCILIATIONS OF NET COST OF OPERATIONS TO BUDGET

AMOUNTS ARE PRESENTED IN MILLIONS	2008	2007
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations Incurred	$ 19,278	$ 16,645
Less: Spending Authority from Offsetting Collections and Recoveries	11,798	12,258
Obligations Net Offsetting Collections and Recoveries	7,480	4,387
Less: Offsetting Receipts	493	488
Net Obligations	6,987	3,899
Other Resources		
Imputed Financing from Costs Absorbed by Others	126	180
Net Other Resources Used to Finance Activities	126	180
Total Resources Used to Finance Activities	**$ 7,113**	**$ 4,079**
Resources Used to Finance Items Not Part of the Net Cost of Operations:		
Change in Budgetary Resources Obligated for Goods, Services and Benefits Ordered But Not Yet Provided	$ (2,429)	$ 1,344
Resources That Fund Expenses Recognized in Prior Periods	(271)	(232)
Budgetary Offsetting Collections and Receipts That Do Not Affect Net Cost of Operations		
Credit Program Collections Which Increase Liabilities for Loan Guarantees or Allowances for Subsidy	9,937	10,216
Change in Unfilled Customer Orders	48	7
Other	493	486
Resources That Finance the Acquisition of Assets	(11,849)	(12,925)
Other Resources or Adjustments to Net Obligated Resources That Do Not Affect Net Cost of Operations	1	2
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	**$ (4,070)**	**$ (1,102)**
Total Resources Used to Finance the Net Cost of Operations	**$ 3,043**	**$ 2,977**
Components of the Net Cost of Operations That Will Not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Periods:		
Increase in Annual Leave Liability	$ 1	$ 0
Upward/Downward Reestimates of Credit Subsidy Expense	875	(222)
Other	3	0
Total Components of Net Cost of Operations That Will Require or Generate Resources in Future Periods	879	(222)
Components Not Requiring or Generating Resources:		
Depreciation and Amortization	9	16
Other Components Not Requiring or Generating Resources		
Bad Debt Expense	(256)	(816)
Other	(2)	(19)
Total Components of Net Cost of Operations That Will Not Require or Generate Resources	(249)	(819)
Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period	630	(1,041)
Net Cost of Operations	**$ 3,673**	**$ 1,936**

REQUIRED SUPPLEMENTARY INFORMATION (Unaudited)

Amounts are presented in millions

	2008 Budgetary	2008 Non-Budgetary Credit Program Financing Accounts	2007 Budgetary	2007 Non-Budgetary Credit Program Financing Accounts
	Rural Community Advancement Programs	Rural Community Advancement Programs	Rural Community Advancement Programs	Rural Community Advancement Programs
Budgetary Resources:				
Unobligated Balance brought forward, Oct. 1	$ 201	$ 356	$ 291	$ 400
Recoveries of Prior Year Unpaid Obligations	74	120	43	90
Budget Authority				
Appropriation	825	0	889	0
Borrowing Authority (Notes 16 & 17)	0	2,801	0	2,135
Spending Authority from Offsetting Collections:				
Earned				
Collected	225	1,150	251	1,131
Change in Receivables from Federal Sources	0	0	0	0
Change in Unfilled Customer Orders				
Without Advance from Federal Sources	0	50	0	32
Nonexpenditure Transfers, Net, Anticipated & Actual	120	0	(5)	0
Permanently Not Available	(263)	(1,531)	(342)	(1,197)
Total Budgetary Resources	**$ 1,182**	**$ 2,946**	**$ 1,127**	**$ 2,591**
Status of Budgetary Resources:				
Obligations Incurred: (Note 15)				
Direct	$ 1,006	2,467	$ 926	$ 2,235
Reimbursable	0	0	0	0
Unobligated Balance:				
Apportioned	142	328	170	128
Unobligated Balance Not Available	34	151	31	228
Total Status of Budgetary Resources	**$ 1,182**	**$ 2,946**	**$ 1,127**	**$ 2,591**
Change in Obligated Balance:				
Obligated Balance, Net				
Unpaid Obligations Brought Forward, Oct. 1	$ 2,475	$ 4,089	$ 2,514	$ 4,149
Uncollected Customer Payments from Federal Sources, Brought Forward, Oct. 1	(2)	(297)	(2)	(265)
Total Unpaid Obligated Balance, Net	**2,473**	**3,792**	**2,512**	**3,884**
Obligations Incurred, Net	1,006	2,467	926	2,235
Gross Outlays	(884)	(2,262)	(922)	(2,205)
Unpaid Obligation Balance Transfers	0	0	0	0
Recoveries of Prior Year Unpaid Obligations	(74)	(120)	(43)	(90)
Change in Uncollected Customer Payments from Federal Sources	0	(50)	0	(32)
Obligated Balance, Net, End of Period:				
Unpaid Obligations (Note 21)	2,523	4,174	2,475	4,089
Uncollected Customer Payments from Federal Sources	(2)	(347)	(2)	(297)
Total Unpaid Obligated Balance, Net, End of Period	**$ 2,521**	**$ 3,827**	**$ 2,473**	**$ 3,792**
Net Outlays				
Gross Outlays	$ 884	$ 2,262	$ 922	$ 2,205
Offsetting Collections	(225)	(1,150)	(251)	(1,131)
Distributed Offsetting Receipts	(128)	0	(146)	0
Total Net Outlays	**$ 531**	**1,112**	**$ 525**	**$ 1,074**

REQUIRED SUPPLEMENTARY INFORMATION (Unaudited)
Amounts are presented in millions

	2008 Budgetary	2008 Non-Budgetary Credit Program Financing Accounts	2007 Budgetary	2007 Non-Budgetary Credit Program Financing Accounts
	Rural Electrification/ Telecommunication Funds	Rural Electrification/ Telecommunication Funds	Rural Electrification/ Telecommunication Funds	Rural Electrification/ Telecommunication Funds
Budgetary Resources:				
Unobligated Balance brought forward, Oct. 1	$ 666	$ 142	$ 1,106	$ 229
Recoveries of Prior Year Unpaid Obligations	15	508	29	679
Budget Authority				
Appropriation	884	0	153	0
Borrowing Authority (Notes 16 & 17)	0	8,044	0	6,342
Spending Authority from Offsetting Collections:				
Earned				
Collected	2,617	2,882	2,917	2,884
Change in Receivables from Federal Sources	0	0	0	0
Change in Unfilled Customer Orders				
Without Advance from Federal Sources	0	(8)	0	(10)
Nonexpenditure Transfers, Net, Anticipated & Actual	0	0	0	0
Permanently Not Available	(2,140)	(1,479)	(2,476)	(2,676)
Total Budgetary Resources	**$ 2,042**	**$ 10,089**	**$ 1,729**	**$ 7,448**
Status of Budgetary Resources:				
Obligations Incurred: (Note 15)				
Direct	$ 783	$ 9,615	$ 1,063	$ 7,306
Reimbursable	0	0	0	0
Unobligated Balance:				
Apportioned	820	474	79	142
Unobligated Balance Not Available	439	0	587	0
Total Status of Budgetary Resources	**$ 2,042**	**$ 10,089**	**$ 1,729**	**$ 7,448**
Change in Obligated Balance:				
Obligated Balance, Net				
Unpaid Obligations Brought Forward, Oct. 1	$ 219	$ 11,794	$ 198	$ 12,176
Uncollected Customer Payments from Federal Sources, Brought Forward, Oct. 1	0	(31)	0	(40)
Total Unpaid Obligated Balance, Net	**219**	**11,763**	**198**	**12,136**
Obligations Incurred, Net	783	9,615	1,063	7,306
Gross Outlays	(886)	(6,471)	(1,013)	(7,010)
Unpaid Obligation Balance Transfers	0	0	0	0
Recoveries of Prior Year Unpaid Obligations	(15)	(508)	(29)	(679)
Change in Uncollected Customer Payments from Federal Sources	0	8	0	10
Obligated Balance, Net, End of Period:				
Unpaid Obligations (Note 21)	101	14,429	219	11,794
Uncollected Customer Payments from Federal Sources	0	(22)	0	(31)
Total Unpaid Obligated Balance, Net, End of Period	**$ 101**	**$ 14,407**	**$ 219**	**$ 11,763**
Net Outlays				
Gross Outlays	$ 886	$ 6,471	$ 1,013	$ 7,010
Offsetting Collections	(2,617)	(2,882)	(2,917)	(2,884)
Distributed Offsetting Receipts	(256)	0	(239)	0
Total Net Outlays	**$ (1,987)**	**$ 3,589**	**$ (2,143)**	**$ 4,126**

REQUIRED SUPPLEMENTARY INFORMATION (Unaudited)

Amounts are presented in millions

	2008 Budgetary	2008 Non-Budgetary Credit Program Financing Accounts	2007 Budgetary	2007 Non-Budgetary Credit Programs Financing Accounts
	Rural Telephone Bank Funds	Rural Telephone Bank Funds	Rural Telephone Bank Funds	Rural Telephone Bank Funds
Budgetary Resources:				
Unobligated Balance brought forward, Oct. 1	$ 40	$ 0	$ 41	$ 3
Recoveries of Prior Year Unpaid Obligations	4	254	2	133
Budget Authority				
Appropriation	1	0	0	0
Borrowing Authority (Notes 16 & 17)	0	41	0	116
Spending Authority from Offsetting Collections:				
Earned				
Collected	0	63	0	80
Change in Receivables from Federal Sources	0	0	0	0
Change in Unfilled Customer Orders				
Without Advance from Federal Sources	0	(6)	0	(3)
Nonexpenditure Transfers, Net, Anticipated & Actual	0	0	0	0
Permanently Not Available	(21)	(255)	(3)	(212)
Total Budgetary Resources	**$ 24**	**$ 97**	**$ 40**	**$ 117**
Status of Budgetary Resources:				
Obligations Incurred: (Note 15)				
Direct	$ 24	$ 70	$ 0	$ 117
Reimbursable	0	0	0	0
Unobligated Balance:				
Apportioned	0	1	0	0
Unobligated Balance Not Available	0	26	40	0
Total Status of Budgetary Resources	**$ 24**	**$ 97**	**$ 40**	**$ 117**
Change in Obligated Balance:				
Obligated Balance, Net				
Unpaid Obligations Brought Forward, Oct. 1	$ 11	$ 723	$ 13	$ 910
Uncollected Customer Payments from Federal Sources, Brought Forward, Oct. 1	0	(12)	0	(15)
Total Unpaid Obligated Balance, Net	**11**	**711**	**13**	**895**
Obligations Incurred, Net	24	70	0	117
Gross Outlays	(25)	(123)	0	(171)
Unpaid Obligation Balance Transfers	0	0	0	0
Recoveries of Prior Year Unpaid Obligations	(4)	(254)	(2)	(133)
Change in Uncollected Customer Payments from Federal Sources	0	6	0	3
Obligated Balance, Net, End of Period:				
Unpaid Obligations (Note 21)	6	415	11	723
Uncollected Customer Payments from Federal Sources	0	(5)	0	(12)
Total Unpaid Obligated Balance, Net, End of Period	**$ 6**	**$ 410**	**$ 11**	**$ 711**
Net Outlays				
Gross Outlays	$ 25	$ 123	$ 0	$ 171
Offsetting Collections	0	(63)	0	(80)
Distributed Offsetting Receipts	(40)	0	(88)	0
Total Net Outlays	**$ (15)**	**$ 60**	**$ (88)**	**$ 91**

REQUIRED SUPPLEMENTARY INFORMATION (Unaudited)
Amounts are presented in millions

	2008 Budgetary	2008 Non-Budgetary Credit Program Financing Accounts	2007 Budgetary	2007 Non-Budgetary Credit Program Financing Accounts
	Rural Housing Funds	**Rural Housing Funds**	**Rural Housing Funds**	**Rural Housing Funds**
Budgetary Resources:				
Unobligated Balance brought forward, Oct. 1	$ 67	$ 747	$ 148	$ 670
Recoveries of Prior Year Unpaid Obligations	19	64	25	78
Budget Authority				
Appropriation	816	0	685	0
Borrowing Authority (Notes 16 & 17)	0	1,228	0	1,834
Spending Authority from Offsetting Collections:				
Earned				
Collected	928	1,831	1,025	1,749
Change in Receivables from Federal Sources	0	0	0	0
Change in Unfilled Customer Orders				
Without Advance from Federal Sources	0	(18)	0	(12)
Nonexpenditure Transfers, Net, Anticipated & Actual	10	0	(9)	0
Permanently Not Available	(915)	(737)	(1,074)	(1,354)
Total Budgetary Resources	**$ 925**	**$ 3,115**	**$ 800**	**$ 2,965**
Status of Budgetary Resources:				
Obligations Incurred: (Note 15)				
Direct	$ 886	$ 2,208	$ 733	$ 2,218
Reimbursable	0	0	0	0
Unobligated Balance:				
Apportioned	11	212	33	166
Unobligated Balance Not Available	28	695	34	581
Total Status of Budgetary Resources	**$ 925**	**$ 3,115**	**$ 800**	**$ 2,965**
Change in Obligated Balance:				
Obligated Balance, Net				
Unpaid Obligations Brought Forward, Oct. 1	$ 204	$ 726	$ 206	$ 765
Uncollected Customer Payments from Federal Sources, Brought Forward, Oct. 1	0	(219)	0	(231)
Total Unpaid Obligated Balance, Net	**204**	**507**	**206**	**534**
Obligations Incurred, Net	886	2,208	733	2,218
Gross Outlays	(878)	(2,181)	(710)	(2,179)
Unpaid Obligation Balance Transfers	0	0	0	0
Recoveries of Prior Year Unpaid Obligations	(19)	(64)	(25)	(78)
Change in Uncollected Customer Payments from Federal Sources	0	18	0	12
Obligated Balance, Net, End of Period:				
Unpaid Obligations (Note 21)	193	689	204	726
Uncollected Customer Payments from Federal Sources	0	(201)	0	(219)
Total Unpaid Obligated Balance, Net, End of Period	**$ 193**	**$ 488**	**$ 204**	**$ 507**
Net Outlays				
Gross Outlays	$ 878	$ 2,181	$ 710	$ 2,179
Offsetting Collections	(928)	(1,831)	(1,025)	(1,749)
Distributed Offsetting Receipts	(57)	0	0	0
Total Net Outlays	**$ (107)**	**$ 350**	**$ (315)**	**$ 430**

REQUIRED SUPPLEMENTARY INFORMATION (Unaudited)
Amounts are presented in millions

	2008 Budgetary	2008 Non-Budgetary Credit Program Financing Accounts	2007 Budgetary	2007 Non-Budgetary Credit Program Financing Accounts
	Rental Assistance Programs	Rental Assistance Programs	Rental Assistance Programs	Rental Assistance Programs
Budgetary Resources:				
Unobligated Balance brought forward, Oct. 1	$ 26	$ 0	$ 15	$ 0
Recoveries of Prior Year Unpaid Obligations	1	0	1	0
Budget Authority				
Appropriation	567	0	690	0
Borrowing Authority (Notes 16 & 17)	0	0	0	0
Spending Authority from Offsetting Collections:				
Earned				
Collected	1	0	0	0
Change in Receivables from Federal Sources	0	0	0	0
Change in Unfilled Customer Orders				
Without Advance from Federal Sources	0	0	0	0
Nonexpenditure Transfers, Net, Anticipated & Actual	2	0	(2)	0
Permanently Not Available	(61)	0	(58)	0
Total Budgetary Resources	**$ 536**	**$ 0**	**$ 646**	**$ 0**
Status of Budgetary Resources:				
Obligations Incurred: (Note 15)				
Direct	$ 520	$ 0	$ 620	$ 0
Reimbursable	0	0	0	0
Unobligated Balance:				
Apportioned	15	0	25	0
Unobligated Balance Not Available	1	0	1	0
Total Status of Budgetary Resources	**$ 536**	**$ 0**	**$ 646**	**$ 0**
Change in Obligated Balance:				
Obligated Balance, Net				
Unpaid Obligations Brought Forward, Oct. 1	$ 1,887	$ 0	$ 2,157	$ 0
Uncollected Customer Payments from Federal Sources, Brought Forward, Oct. 1	0	0	0	0
Total Unpaid Obligated Balance, Net	**1,887**	**0**	**2,157**	0
Obligations Incurred, Net	520	0	620	0
Gross Outlays	(932)	0	(889)	0
Unpaid Obligation Balance Transfers	5	0	0	0
Recoveries of Prior Year Unpaid Obligations	(1)	0	(1)	0
Change in Uncollected Customer Payments from Federal Sources	0	0	0	0
Obligated Balance, Net, End of Period:				
Unpaid Obligations (Note 21)	1,479	0	1,887	0
Uncollected Customer Payments from Federal Sources	0	0	0	0
Total Unpaid Obligated Balance, Net, End of Period	**$ 1,479**	**$ 0**	**$ 1,887**	**$ 0**
Net Outlays				
Gross Outlays	$ 932	$ 0	$ 889	$ 0
Offsetting Collections	(1)	0	0	0
Distributed Offsetting Receipts	0	0	0	0
Total Net Outlays	**$ 931**	**$ 0**	**$ 889**	**$ 0**

REQUIRED SUPPLEMENTARY INFORMATION (Unaudited)

Amounts are presented in millions

	2008 Budgetary	2008 Non-Budgetary Credit Program Financing Accounts	2007 Budgetary	2007 Non-Budgetary Credit Program Financing Accounts
	Rural Housing Grants	Rural Housing Grants	Rural Housing Grants	Rural Housing Grants
Budgetary Resources:				
Unobligated Balance brought forward, Oct. 1	$ 56	$ 0	$ 24	$ 0
Recoveries of Prior Year Unpaid Obligations	13	10	15	3
Budget Authority				
Appropriation	100	0	128	0
Borrowing Authority (Notes 16 & 17)	0	99	0	55
Spending Authority from Offsetting Collections:				
Earned				
Collected	0	29	0	9
Change in Receivables from Federal Sources	0	0	0	0
Change in Unfilled Customer Orders				
Without Advance from Federal Sources	0	23	0	6
Nonexpenditure Transfers, Net, Anticipated & Actual	(14)	0	8	0
Permanently Not Available	(1)	(19)	0	(5)
Total Budgetary Resources	**$ 154**	**$ 142**	**$ 175**	**$ 68**
Status of Budgetary Resources:				
Obligations Incurred: (Note 15)				
Direct	$ 123	$ 139	$ 119	$ 68
Reimbursable	0	0	0	0
Unobligated Balance:				
Apportioned	28	3	53	0
Unobligated Balance Not Available	3	0	3	0
Total Status of Budgetary Resources	**$ 154**	**$ 142**	**$ 175**	**$ 68**
Change in Obligated Balance:				
Obligated Balance, Net				
Unpaid Obligations Brought Forward, Oct. 1	$ 225	$ 112	$ 234	$ 64
Uncollected Customer Payments from Federal Sources, Brought Forward, Oct. 1	0	(23)	0	(17)
Total Unpaid Obligated Balance, Net	**225**	**89**	**234**	**47**
Obligations Incurred, Net	123	139	119	68
Gross Outlays	(104)	(56)	(113)	(17)
Unpaid Obligation Balance Transfers	(5)	0	0	0
Recoveries of Prior Year Unpaid Obligations	(13)	(10)	(15)	(3)
Change in Uncollected Customer Payments from Federal Sources	0	(23)	0	(6)
Obligated Balance, Net, End of Period:				
Unpaid Obligations (Note 21)	226	185	225	112
Uncollected Customer Payments from Federal Sources	0	(46)	0	(23)
Total Unpaid Obligated Balance, Net, End of Period	**$ 226**	**$ 139**	**$ 225**	**$ 89**
Net Outlays				
Gross Outlays	$ 104	$ 56	$ 113	$ 17
Offsetting Collections	0	(29)	0	(9)
Distributed Offsetting Receipts	0	0	0	0
Total Net Outlays	**$ 104**	**$ 27**	**$ 113**	**$ 8**

REQUIRED SUPPLEMENTARY INFORMATION (Unaudited)

Amounts are presented in millions

	2008 Budgetary	2008 Non-Budgetary Credit Program Financing Accounts	2007 Budgetary	2007 Non-Budgetary Credit Program Financing Accounts
	Salaries & Expense	Salaries & Expense	Salaries & Expense	Salaries & Expense
Budgetary Resources:				
Unobligated Balance brought forward, Oct. 1	$ 34	$ 0	$ 40	$ 0
Recoveries of Prior Year Unpaid Obligations	35	0	32	0
Budget Authority				
Appropriation	170	0	162	0
Borrowing Authority (Notes 16 & 17)	0	0	0	0
Spending Authority from Offsetting Collections:				
Earned				
Collected	510	0	512	0
Change in Receivables from Federal Sources	0	0	0	0
Change in Unfilled Customer Orders				
Without Advance from Federal Sources	0	0	0	0
Nonexpenditure Transfers, Net, Anticipated & Actual	0	0	8	0
Permanently Not Available	(14)	0	(15)	0
Total Budgetary Resources	**$ 735**	**$ 0**	**$ 739**	**$ 0**
Status of Budgetary Resources:				
Obligations Incurred: (Note 15)				
Direct	$ 194	$ 0	$ 188	$ 0
Reimbursable	512	0	517	0
Unobligated Balance:				
Apportioned	3	0	5	0
Unobligated Balance Not Available	26	0	29	0
Total Status of Budgetary Resources	**$ 735**	**$ 0**	**$ 739**	**$ 0**
Change in Obligated Balance:				
Obligated Balance, Net				
Unpaid Obligations Brought Forward, Oct. 1	$ 125	$ 0	$ 119	$ 0
Uncollected Customer Payments from Federal Sources, Brought Forward, Oct. 1	(1)	0	(1)	0
Total Unpaid Obligated Balance, Net	**124**	**0**	**118**	0
Obligations Incurred, Net	706	0	705	0
Gross Outlays	(682)	0	(667)	0
Unpaid Obligation Balance Transfers	0	0	0	0
Recoveries of Prior Year Unpaid Obligations	(35)	0	(32)	0
Change in Uncollected Customer Payments from Federal Sources	0	0	0	0
Obligated Balance, Net, End of Period:				
Unpaid Obligations (Note 21)	114	0	125	0
Uncollected Customer Payments from Federal Sources	(1)	0	(1)	0
Total Unpaid Obligated Balance, Net, End of Period	**$ 113**	**$ 0**	**$ 124**	**$ 0**
Net Outlays				
Gross Outlays	$ 682	$ 0	$ 667	$ 0
Offsetting Collections	(510)	0	(512)	0
Distributed Offsetting Receipts	0	0	(2)	0
Total Net Outlays	**$ 172**	**$ 0**	**$ 153**	**$ 0**

REQUIRED SUPPLEMENTARY INFORMATION (Unaudited)
Amounts are presented in millions

	2008 Budgetary	2008 Non-Budgetary Credit Program Financing Accounts	2007 Budgetary	2007 Non-Budgetary Credit Program Financing Accounts
	Other	Other	Other	Other
Budgetary Resources:				
Unobligated Balance brought forward, Oct. 1	$ 93	$ 2	$ 153	$ 3
Recoveries of Prior Year Unpaid Obligations	10	163	22	363
Budget Authority				
Appropriation	306	0	115	0
Borrowing Authority (Notes 16 & 17)	0	498	0	364
Spending Authority from Offsetting Collections:				
Earned				
Collected	93	152	92	130
Change in Receivables from Federal Sources	(21)	0	(44)	0
Change in Unfilled Customer Orders				
Without Advance from Federal Sources	0	7	0	(6)
Nonexpenditure Transfers, Net, Anticipated & Actual	1	0	14	0
Permanently Not Available	(41)	(216)	(118)	(458)
Total Budgetary Resources	**$ 441**	**$ 606**	**$ 234**	**$ 396**
Status of Budgetary Resources:				
Obligations Incurred: (Note 15)				
Direct	$ 164	$ 567	$ 141	$ 394
Reimbursable	0	0	0	0
Unobligated Balance:				
Apportioned	215	39	62	2
Unobligated Balance Not Available	62	0	31	0
Total Status of Budgetary Resources	**$ 441**	**$ 606**	**$ 234**	**$ 396**
Change in Obligated Balance:				
Obligated Balance, Net				
Unpaid Obligations Brought Forward, Oct. 1	$ 264	$ 925	$ 283	$ 1,107
Uncollected Customer Payments from Federal Sources, Brought Forward, Oct. 1	(26)	(59)	(70)	(66)
Total Unpaid Obligated Balance, Net	**238**	**866**	**213**	**1,041**
Obligations Incurred, Net	164	567	141	394
Gross Outlays	(137)	(176)	(138)	(212)
Unpaid Obligation Balance Transfers	0	0	0	0
Recoveries of Prior Year Unpaid Obligations	(10)	163	(22)	(363)
Change in Uncollected Customer Payments from Federal Sources	21	(7)	44	6
Obligated Balance, Net, End of Period:				
Unpaid Obligations (Note 21)	281	1,154	264	925
Uncollected Customer Payments from Federal Sources	(5)	(67)	(26)	(59)
Total Unpaid Obligated Balance, Net, End of Period	**$ 276**	**$ 1,087**	**$ 238**	**$ 866**
Net Outlays				
Gross Outlays	$ 137	$ 176	$ 138	$ 212
Offsetting Collections	(93)	(152)	(92)	(130)
Distributed Offsetting Receipts	(12)	0	(13)	0
Total Net Outlays	**$ 32**	**$ 24**	**$ 33**	**$ 82**

REQUIRED SUPPLEMENTARY INFORMATION (Unaudited)

Amounts are presented in millions

	2008 Budgetary	2008 Non-Budgetary Credit Program Financing Accounts	2007 Budgetary	2007 Non-Budgetary Credit Program Financing Accounts
	Total	Total	Total	Total
Budgetary Resources:				
Unobligated Balance brought forward, Oct. 1	$ 1,183	$ 1,247	$ 1,818	$ 1,305
Recoveries of Prior Year Unpaid Obligations	171	1,119	169	1,346
Budget Authority				
Appropriation	3,669	0	2,822	0
Borrowing Authority (Notes 16 & 17)	0	12,711	0	10,846
Spending Authority from Offsetting Collections:				
Earned				
Collected	4,374	6,107	4,797	5,983
Change in Receivables from Federal Sources	(21)	0	(44)	0
Change in Unfilled Customer Orders				
Without Advance from Federal Sources	0	48	0	7
Nonexpenditure Transfers, Net, Anticipated & Actual	119	0	14	0
Permanently Not Available	(3,456)	(4,237)	(4,086)	(5,902)
Total Budgetary Resources	**$ 6,039**	**$ 16,995**	**$ 5,490**	**$ 13,585**
Status of Budgetary Resources:				
Obligations Incurred: (Note 15)				
Direct	$ 3,700	$ 15,066	$ 3,790	$ 12,338
Reimbursable	512	0	517	0
Unobligated Balance:				
Apportioned	1,234	1,057	427	438
Unobligated Balance Not Available	593	872	756	809
Total Status of Budgetary Resources	**$ 6,039**	**$ 16,995**	**$ 5,490**	**$ 13,585**
Change in Obligated Balance:				
Obligated Balance, Net				
Unpaid Obligations Brought Forward, Oct. 1	$ 5,410	$ 18,369	$ 5,724	$ 19,171
Uncollected Customer Payments from Federal Sources, Brought Forward, Oct. 1	(29)	(641)	(73)	(634)
Total Unpaid Obligated Balance, Net	**5,381**	**17,728**	**5,651**	**18,537**
Obligations Incurred, Net	4,212	15,066	4,307	12,338
Gross Outlays	(4,528)	(11,269)	(4,452)	(11,794)
Unpaid Obligation Balance Transfers	0	0	0	0
Recoveries of Prior Year Unpaid Obligations	(171)	(1,119)	(169)	(1,346)
Change in Uncollected Customer Payments from Federal Sources	21	(48)	44	(7)
Obligated Balance, Net, End of Period:				
Unpaid Obligations (Note 21)	4,923	21,046	5,410	18,369
Uncollected Customer Payments from Federal Sources	(8)	(688)	(29)	(641)
Total Unpaid Obligated Balance, Net, End of Period	**$ 4,915**	**$ 20,358**	**$ 5,381**	**$ 17,728**
Net Outlays				
Gross Outlays	$ 4,528	$ 11,269	$ 4,452	$ 11,794
Offsetting Collections	(4,374)	(6,107)	(4,797)	(5,983)
Distributed Offsetting Receipts	(493)	0	(488)	0
Total Net Outlays	**$ (339)**	**$ 5,162**	**$ (833)**	**$ 5,811**