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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

B-159292

To the President of the Senate and the
Speaker of the House of Representatives

This report presents our opinion on the Rural Telephone Bank's financial statements for the year ended September 30, 1983. We made our examination pursuant to the provisions of 31 U.S.C. 9105 and in accordance with generally accepted government auditing standards.

The Rural Telephone Bank was established in 1971 to provide supplemental financing for the Rural Electrification Administration's telephone program borrowers. The Rural Telephone Bank and the Rural Electrification Administration are agencies of the Department of Agriculture.

We are sending copies of this report to the Director of the Office of Management and Budget, the Secretaries of the Treasury and Agriculture, and the Board of Directors of the Rural Telephone Bank.

Charles A. Bosha
Comptroller General
of the United States



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-159292

To the Board of Directors
Rural Telephone Bank

We have examined the statement of financial condition of the Rural Telephone Bank as of September 30, 1983, and the related statements of income, expenses and changes in patronage capital, and changes in financial condition for the year then ended. Our examination was made in accordance with generally accepted government auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of the Rural Telephone Bank as of September 30, 1983, and the results of its operations, the changes in its patronage capital, and the changes in its financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. The financial statements of the Rural Telephone Bank for the year ended September 30, 1982, were not audited by us and, accordingly, we do not express an opinion on them.

A handwritten signature in black ink, reading "Charles A. Bowles".

Comptroller General
of the United States

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REPORT ON INTERNAL ACCOUNTING CONTROLS

As part of our examination of the Rural Telephone Bank's financial statements for the year ended September 30, 1983, we made a study and evaluation of the system of internal accounting control to the extent we considered necessary to evaluate the system as required by generally accepted government auditing standards. For the purpose of this report, we have classified the significant internal accounting controls in the following categories:

- expenditures,
- financial reporting,
- loans, and
- treasury.

Our study included all of the control categories listed above, but we did not evaluate the accounting controls over the expenditures, financial reporting, and treasury categories because it was more efficient to expand substantive audit tests. The purpose of our study and evaluation was to determine the nature, timing, and extent of the auditing procedures necessary for expressing an opinion on the Bank's financial statements. Our study and evaluation was more limited than would be necessary to express an opinion on the system of internal accounting control taken as a whole or on any of the categories of controls identified above.

The management of the Rural Telephone Bank is responsible for establishing and maintaining a system of internal accounting control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any system of internal accounting control, errors or irregularities may nevertheless occur and not be detected. Also, projection of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate.

Our study and evaluation made for the limited purpose described in the first paragraph would not necessarily disclose all material weaknesses in the system. Accordingly, we do not express an opinion on the system of internal accounting control of the Rural Telephone Bank taken as a whole or on any of the categories of controls identified in the first paragraph. However, our study and evaluation disclosed no condition that we believe to be a material weakness.

REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

We have examined the financial statements of the Rural Telephone Bank for the year ended September 30, 1983. Our examination was made in accordance with generally accepted government auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures, including tests of compliance with laws and regulations, as we considered necessary in the circumstances.

In our opinion, the Rural Telephone Bank complied with the terms and provisions of laws and regulations for the transactions tested that could have materially affected the Bank's financial statements.

Nothing came to our attention in connection with our examination that caused us to believe that the Bank was not in compliance with the terms and provisions of laws and regulations for those transactions not tested.

RURAL TELEPHONE BANK
COMPARATIVE STATEMENT OF FINANCIAL CONDITION
AS OF SEPTEMBER 30, 1983 AND 1982 (Notes 1 and 2)

	<u>ASSETS</u>	
	(unaudited)	
	September 30,	
	<u>1983</u>	<u>1982</u>
Cash	\$ 6,192,282	\$ 48,187
Investments (Note 3):		
U.S. Government Securities at Amortized Cost	2,935,304	2,930,393
Interest Receivable	29,185	29,185
Total Investments	<u>2,964,489</u>	<u>2,959,578</u>
Loans Receivable (Note 4)	1,253,893,373	1,172,843,721
Interest Receivable on Loans	8,791,879	8,096,651
	<u>1,262,685,252</u>	<u>1,180,940,372</u>
Less: Allowance for Possible Losses	<u>3,386,000</u>	<u>2,885,000</u>
Net Loans and Interest Receivable	<u>1,259,299,252</u>	<u>1,178,055,372</u>
Other Assets	<u>534</u>	<u>696</u>
Total Assets	<u>\$1,268,456,557</u>	<u>\$1,181,063,833</u>

<u>LIABILITIES AND EQUITY</u>		
Accounts Payable	\$ 34,116	\$ 15,505
Loans Payable to U.S. Treasury (Note 5)	720,629,000	679,188,000
Accrued Interest on Loans Payable to U.S. Treasury	<u>17,775,122</u>	<u>16,697,494</u>
Total Liabilities (Note 6)	<u>738,438,238</u>	<u>695,900,999</u>
Equity:		
Investment of U.S. Government:		
Class A Stock (Note 7)	360,000,000	330,000,000
Investment of Others (Note 7):		
Class B Stock	106,782,744	96,872,744
Class C Stock	1,620,000	1,448,000
Total Capital Stock	<u>468,402,744</u>	<u>428,320,744</u>
Patronage Capital for the Period (Note 8)	11,277,646	10,262,189
Reserve for Contingencies (Note 8)	<u>50,337,929</u>	<u>46,579,901</u>
Total Equity	<u>530,018,319</u>	<u>485,162,834</u>
Total Liabilities and Equity	<u>\$1,268,456,557</u>	<u>\$1,181,063,833</u>

The accompanying notes are an integral part of this statement.

RURAL TELEPHONE BANK
COMPARATIVE STATEMENT OF INCOME, EXPENSES AND CHANGES IN PATRONAGE CAPITAL
FOR THE FISCAL YEARS ENDED SEPTEMBER 30, 1983 AND 1982 (Notes 1 and 2)

	(unaudited)	
	Fiscal Years Ended September 30,	
	<u>1983</u>	<u>1982</u>
INCOME:		
Interest Earned on Loans	\$88,052,466	\$80,034,983
Interest Earned on Investments	192,588	198,703
Total Income	<u>88,245,054</u>	<u>80,233,686</u>
EXPENSES:		
Interest on Funds Borrowed		
from U.S. Treasury	69,544,977	62,975,915
Directors' Fees	9,100	12,600
Directors' Travel	21,602	24,282
Postage	2,146	2,581
Provision for Possible Losses	501,000	507,000
Miscellaneous	1,339	1,404
U.S. General Accounting Office		
Audit Fee	30,000	-0-
Total Expenses	<u>70,110,164</u>	<u>63,523,782</u>
NET INCOME FOR THE PERIOD	18,134,890	16,709,904
Less: Provision for Return on		
Class A Stock	<u>6,857,244</u>	<u>6,447,715</u>
PATRONAGE CAPITAL	<u>\$11,277,646</u>	<u>\$10,262,189</u>
PATRONAGE CAPITAL BEGINNING		
OF PERIOD	\$10,262,189	\$10,804,974
Plus: Net Income for the Period	18,134,890	16,709,904
Less: Transfer to Reserve for		
Contingencies	3,758,028	3,770,986
Provision for Return on		
Class A Stock	6,857,244	6,447,715
Patronage Refund in Form		
of Class B Stock (Note 8)	6,402,801	6,937,598
Class C Stock Cash Dividend	<u>101,360</u>	<u>96,390</u>
PATRONAGE CAPITAL END OF PERIOD (Note 8)	<u>\$11,277,646</u>	<u>\$10,262,189</u>

The accompanying notes are an integral part of this statement.

RURAL TELEPHONE BANK
 COMPARATIVE STATEMENT OF CHANGES IN FINANCIAL CONDITION
 FOR THE FISCAL YEARS ENDED SEPTEMBER 30, 1983 AND 1982

	(unaudited)	
	<u>Fiscal Year Ended September 30,</u>	
	<u>1983</u>	<u>1982</u>
SOURCES OF CASH:		
Net Income	\$ 18,134,890	\$ 16,709,904
Items not Affecting Cash:		
Provision for Possible Losses	501,000	507,000
Amortization of Net Premium (Discount)	(4,911)	(4,897)
Increase in:		
Interest Payable U.S. Treasury	1,077,628	2,117,912
Accounts Payable	18,611	9,035
Borrowings from U.S. Treasury	41,441,000	54,886,000
Decrease in Interest Receivable on U.S. Government Securities	-0-	564
Investments Matured	-0-	210,000
Loan Principal Collected	12,353,184	10,347,393
Stock Issued:		
Class A Stock	30,000,000	30,000,000
Class C Stock	109,354	71,000
Total Sources of Cash	<u>\$103,630,756</u>	<u>\$114,853,911</u>
USES OF CASH:		
Advances on Loan Commitments	\$ 89,832,991	\$107,365,243
Increase in:		
Prepaid Expenses (Decrease)	(162)	153
Interest Receivable on Loans	695,228	896,420
Return on Class A Stock	6,857,244	6,447,715
Dividend on Class C Stock	101,360	96,390
Total Uses of Cash	<u>\$ 97,486,661</u>	<u>\$114,805,921</u>
INCREASE IN CASH	<u>\$ 6,144,095</u>	<u>\$ 47,990</u>
Beginning Cash	\$ 48,187	\$ 197
Ending Cash	6,192,282	48,187
Increase	<u>\$ 6,144,095</u>	<u>\$ 47,990</u>

The accompanying notes are an integral part of this statement.

RURAL TELEPHONE BANK
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 1983

1. BACKGROUND INFORMATION

Mission

The Rural Telephone Bank (RTB or the Bank) was established on May 7, 1971, to provide a supplemental source of financing for the Rural Electrification Administration's (REA) telephone program. The REA is a credit agency of the Department of Agriculture which assists organizations with financing of electric or telephone service in rural areas.

Management By Related Party

The Bank currently is an agency of the U.S. Government, subject to the supervision and direction of the Secretary of Agriculture. As provided by law, the Administrator of Agriculture's Rural Electrification Administration serves as the Governor of the Bank. In this capacity, the Governor may exercise and perform all functions, powers, and duties of the Bank, except for matters specifically reserved for its Board.

Overall policy decisions and management vests in the Board of Directors. The 13-member Board is composed of the following:

- the Governor of the RTB;
- the Governor of the Farm Credit Administration;
- 5 members appointed by the President; and
- 6 members elected by RTB stockholders.

The Board meets as necessary, but by law it must hold at least four regularly scheduled meetings a year.

The Bank's Treasurer is elected by the Board of Directors. The Director of REA's Fiscal Accounting Division is designated to act as the Assistant Treasurer and performs the Bank's daily functions.

Conversion

According to authorizing legislation and amendments, the Bank will be converted to independent status when 51 percent of the Class A stock issued to the United States and outstanding any time after September 30, 1995, has been fully redeemed and retired. When such conversion occurs, the Bank will no longer be an agency of the Department of Agriculture and the President will cease to appoint Board members; however, the Congress may continue its oversight responsibilities for the Bank's operations.

Operations

RTB's enabling legislation, Section 403(b) of the Rural Electrification Act (RE Act), authorizes it to partially or jointly use the facilities and services of REA, or any other agency of the Department of Agriculture without cost.

The Bank's operations are conducted by REA employees who carry out similar responsibilities under REA's rural telephone program. REA and the Department's Office of General Counsel provide administrative support to the Bank without reimbursement.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis Of Accounting - The financial statements are prepared on the accrual basis of accounting. In accordance with generally accepted accounting principles, the Statement of Changes in Financial Condition has been changed to the cash basis from the working capital basis. The change required the restatement of the 1982 Statement of Changes in Financial Condition to conform to the 1983 presentation.

Allowance For Possible Losses On Loans And Interest Receivable - The U.S. Treasury tax formula, which commercial banks reporting to the Federal Reserve System are required to use in making provisions for possible loan losses, is used to determine quarterly adjustments to the allowance for possible losses on loans and interest receivable. The allowance for possible losses ratio is adjusted quarterly to 0.006 percent of the loans outstanding at the end of each quarter, multiplied by the number of quarters elapsed since June 30, 1972, until a maximum allowance of 0.6 percent of loans and interest receivable has been attained. Quarterly adjustments to increase the ratio of the allowance to outstanding loans and interest receivable are charged to expense.

3. INVESTMENTS - U.S. Government securities are stated at cost, adjusted for amortization of premiums and discounts, both computed by the straight-line method. The Bank intends to hold these securities until maturity. The market value of U.S. Government securities at September 30, 1983 and 1982, was \$2,675,904 and \$2,568,581, respectively. Bonds in the amount of \$1,759,000 will mature August 15, 1984.
4. LOANS RECEIVABLE - Notes evidencing indebtedness of the Bank's loans are generally for 35 years. They are secured by a first mortgage, which also secures, equally and ratably, notes evidencing indebtedness of REA loans. Interest earned on loans

is credited to revenue on an accrual basis, based upon the principal amount outstanding. Loans receivable were as follows:

	(unaudited)	
	September 30,	
	1983	1982
Cumulative advances on commitments	\$1,313,060,353	\$1,219,657,517
Cumulative principal repayments	59,166,980	46,813,796
Loans receivable	<u>\$1,253,893,373</u>	<u>\$1,172,843,721</u>

5. LOANS PAYABLE TO U.S. TREASURY - On July 26, 1973, the Governor executed an open end note payable to the Secretary of the Treasury to cover loans to be obtained under Section 407 of the RE Act, as amended (7 U.S.C. 947). Advances on the note, in each fiscal year, are to be repaid within 50 years from the June 30th following the date of advance, at a rate of interest established by the Secretary of the Treasury for the calendar month in which each advance is made. Repayments may be made at any time before maturity and apply to the oldest advance outstanding. As of September 30, 1983 and 1982, the Bank's cumulative debenture borrowings from the Treasury amounted to \$721 and \$679 million, respectively, at interest rates ranging from 7.25 to 14.625 percent.

The outstanding telephone debenture value may not exceed 20 times the RTB's equity. As of September 30, 1983 and 1982, the Bank's cumulative borrowing authority totaled \$10.6 billion and \$9.7 billion, respectively.

6. UNADVANCED LOAN COMMITMENTS - Liabilities do not include the following unadvanced loan commitments:

	(unaudited)	
	September 30,	
	1983	1982
Cumulative loan commitments	\$1,860,593,433	\$1,694,587,539
Cumulative advances on commitments	1,313,060,353	1,219,657,517
Unadvanced on commitments	<u>\$ 547,533,080</u>	<u>\$ 474,930,022</u>

7. INVESTMENT OF THE U.S. GOVERNMENT AND OTHERS

Class A Stock - Issued at a par value of \$1 per share to the Administrator of REA, on behalf of the Government, in exchange for a Government appropriation for the purchase of Class A stock by REA. The stock shall be entitled to a cumulative return, payable from the Bank's income, at a rate of two percent per annum.

Class B Stock - Issued at a par value of \$1 per share and must be purchased at par by RTB borrowers in amounts equal to 5 percent of the approved loan amount, excluding the amount borrowed to purchase such stock. During fiscal year 1983, Class B stock issued, net of recessions and conversion to Class C stock, totaled \$3,523,155. Class B stock is issued to the borrower when funds are advanced. It may be converted to Class C stock upon payment in full of the loan.

Due to the uncertainty of a borrower drawing down the entire approved loan amount, subscriptions receivable are not shown on the balance sheet. Subscriptions receivable amounted to \$16,091,360 and \$11,756,260 for fiscal years ended September 30, 1983 and 1982, respectively. Additional Class B stock is issued in the form of patronage refunds as described in Note 8.

	(unaudited)	
	September 30,	
	1983	1982
Class B Stock Issued and Committed for Issuance	\$ 88,571,356	\$ 80,713,101
Less: Subscriptions Receivable	16,091,360	11,756,260
Subscriptions Paid	72,479,996	68,956,841
Cumulative Patronage Refund Issued and Outstanding	34,302,748	27,915,903
Total Class B Stock Issued	\$ 106,782,744	\$ 96,872,744

Class C Stock - Issued at a par value of \$1,000 per share to borrowers, corporations, and public entities eligible to borrow or by organizations controlled by such borrowers, corporations, and public bodies. Class C stock outstanding includes \$63,000 issued as a result of conversion from Class B stock.

8. PATRONAGE CAPITAL - Patronage capital for the end of the period is distributed in accordance with the provisions of Section 8.2 of Article VIII of the Bank's bylaws, as follows:

Reserve for Contingencies - After the close of each fiscal year not less than 10 percent of the patronage capital, as determined by the Board of Directors, shall be placed in a contingency reserve until such time as this reserve shall equal at least 50 percent of the outstanding capital stock. The reserve shall be used to offset and liquidate operating losses and deficits, as determined by the Board of Directors.

Patronage Refunds - The balance of patronage capital shall be distributed to each holder of Class B stock as patronage refunds, in the form of Class B stock, as soon as practicable after the close of each fiscal year.

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