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Accounting and Financial
Management Division

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February 5, 1990

The Honorable Robert E. Wise, Jr.
Chairman, Subcommittee on Government Information,
Justice and Agriculture
Committee on Government Operations
House of Representatives

Dear Mr. Chairman:

Your letter of January 22, 1990, asked for information on section 24 of H.R. 3564 and section 724 of H.R. 3581. These sections contain an identical provision to encourage a broad range of investments in rural development projects by Rural Electrification Administration (REA) and Rural Telephone Bank (RTB) telephone loan borrowers. Borrowers must have a net worth of at least 20 percent of their total assets to participate and may invest up to one third of their net worth in rural development projects.

To determine how the proposed legislation could affect repayment of REA and RTB telephone loans, we analyzed selected financial data on telephone loan borrowers. As agreed with your office, we requested that REA and RTB provide us with summary information on the financial position and operating results of these borrowers. REA and RTB provided us with data on borrowers as of December 31, 1988. We did not verify the accuracy of the data. A discussion of the financial data for the eligible telephone loan borrowers follows.

SELECTED FINANCIAL DATA FOR ELIGIBLE RURAL TELEPHONE COMPANY BORROWERS

As of December 31, 1988, of 964 rural telephone borrowers, 804, or 83 percent, had a ratio of net worth to total assets of at least 20 percent. Financial information on these 804 rural telephone borrowers includes the following.

-- The 804 borrowers had total assets of $14,833 million, total liabilities of $8,930 million, and total net worth of $5,903 million. Their average net worth was 40 percent of total assets against debt of 60 percent of total assets. This amount of net worth provides these borrowers with a cushion to repay debt when due.

-- The bills' provision that allows borrowers to invest up to one third of net worth could generate investments of $1,968 million, or an average of $2.4 million per borrower. We did not determine whether this amount is sufficient to fund a rural development project without additional borrowing or pooling of net worth from eligible RTB borrowers.

-- The borrowers held net telephone plant assets of $11,535 million, or 78 percent of total assets. Total telephone plant, including accumulated depreciation of $6,386 million, amounted to $17,921 million. The high percentage of total assets invested in telephone plant limits cash available for other investments.

-- Investments in affiliates, other investments, and other noncurrent assets which are considered nonliquid accounted for $713 million, or 5 percent of total assets.

-- The borrowers had cash and equivalents of $1,371 million and other current assets of $1,214 million, which together account for 17 percent of total assets. They had current liabilities of $1,748 million, with a ratio of current assets to current liabilities of 1.48. In order to invest cash in rural development projects, telephone borrowers would have to use their current assets, reducing the amount available to meet current liabilities and operating expenses. Borrowers would have to balance their cash flow between the amount of investment funds needed (up to the one third of net worth limit) and the amount of cash needed to sustain operations.

-- Total net income for the year ended December 31, 1988, was $1,105 million after provision for federal income taxes of $353 million. Dividends for 1988 were $558 million, or 50 percent of net income. Although high, this is not an unusual dividend payout for utility operations. In the event of cash flow difficulties, cash dividends could be reduced or postponed to provide cash for debt repayment. According to their standard borrower's agreement, REA and RTB can suspend payment of dividends if federal government debt is endangered or past due.

-- Their interest expense for 1988 was $341 million, with an interest to income earned ratio of 5.3. This ratio is considered adequate by financial analysts. As discussed with your office, information on the amount of principal repayments on the 30-year REA and RTB loans was not readily available to determine its effect on cash flows. The standard borrower's agreement provides that borrowers must obtain an annual financial audit by an independent certified public accountant and submit an annual report. These requirements provide some assurance that the viability of a borrower's financial operations can be properly monitored by REA and RTB and thereby provide some early warning of financial trouble. Should a payment problem occur, it could be addressed through a reduction of dividends or a debt rescheduling.

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The data we reviewed indicate that telephone loan borrowers have a satisfactory net worth, are limited in the amount of cash available for investment, and have an adequate interest to income earned ratio. In addition, several mechanisms to limit potential financial difficulties are available, such as decreased cash dividends, debt rescheduling, and close monitoring of borrowers' financial audit results.

Also, the proposed legislation is more restrictive to telephone borrowers than current investment authority for electric borrowers. The Omnibus Budget Reconciliation Act of 1987 (7 U.S.C. 940b) authorized electric borrowers to invest up to 15 percent of their total utility plant assets in rural community infrastructure projects without REA approval. If this criterion were applied to eligible telephone loan borrowers, 15 percent of their total telephone plant would amount to $2,688 million. This amount is about 46 percent of their total net worth, rather than the one-third limit specified in the proposed legislation.

On January 16, 1990, we briefed your office on the results of our analysis contained in this letter. If you or any of your staff would like to discuss further the information provided or need additional assistance, please call me or Roger Stoltz, Assistant Director, at 275-9406.

Sincerely yours,

Robert W. Gramling

Robert W. Gramling
Director, Corporate Financial Audits

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