



U.S. Department of Agriculture



Office of Inspector General
Financial & IT Operations

Audit Report

Rural Telephone Bank's Financial Statements for Fiscal Years 2005 and 2004

Report No. 15401-6-FM
November 2005



UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250



November 9, 2005

REPLY TO

ATTN OF: 15401-6-FM

TO: Board of Directors
Rural Telephone Bank

ATTN: John M. Purcel
Director
Financial Management Division
Rural Development

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

SUBJECT: Rural Telephone Bank's Financial Statements for
Fiscal Years 2005 and 2004

This report represents the auditors' opinion on the Rural Telephone Bank's (RTB) principal financial statements for the fiscal years ended September 30, 2005 and 2004. Reports on RTB's internal control and on its compliance with laws and regulations are also provided.

Gardiner, Kamy & Associates, P.C. (GKA), an independent certified public accounting firm, conducted the audits. We monitored the progress of the audits at all key points, reviewed the workpapers, and performed other procedures, as we deemed necessary. We determined the audits were conducted in accordance with generally accepted auditing standards, Government Auditing Standards (issued by the Comptroller General of the United States), and the Office of Management and Budget (OMB) Bulletin No. 01-02, "Audit Requirements for Federal Financial Statements."

It is the opinion of GKA that the financial statements present fairly, in all material respects, RTB's financial position as of September 30, 2005 and 2004; and its net costs, changes in net position, budgetary resources and reconciliation of net costs to budgetary obligations for the years then ended, in conformity with generally accepted accounting principles.

GKA's report on RTB's internal control contains one material weaknesses relating to information technology. GKA's report on RTB's compliance with laws and regulations addresses noncompliance with the Federal Financial Management Improvement Act.

In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing the corrective actions taken or planned, including the timeframes to address the report's recommendations. Please note that the regulation requires a management decision to be reached on all findings and recommendations within a maximum of 6 months from report issuance.



GARDINER KAMYA
& ASSOCIATES, PC

CERTIFIED PUBLIC ACCOUNTANTS | MANAGEMENT CONSULTANTS

**U.S. DEPARTMENT OF AGRICULTURE
RURAL TELEPHONE BANK (RTB)**

**FINANCIAL STATEMENTS
SEPTEMBER 30, 2005 AND 2004**

and

INDEPENDENT AUDITOR'S REPORT THEREON

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**U.S. DEPARTMENT OF AGRICULTURE
RURAL TELEPHONE BANK (RTB)**

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Independent Auditor's Report on Financial Statements

To the Inspector General and the
Rural Telephone Bank Board of Directors

We have audited the accompanying Balance Sheets of the Rural Telephone Bank (RTB), an agency of the United States Department of Agriculture, as of September 30, 2005 and 2004, and the related Statements of Net Cost, Changes in Net Position, Budgetary Resources and Financing for the years then ended. These financial statements are the responsibility of the management of the RTB. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the RTB as of September 30, 2005 and 2004, and its net costs, changes in net position, budgetary resources, and the reconciliation of budgetary obligations to net costs for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Footnote 1.J, the President's Fiscal Year 2006 Budget provides for the dissolution of the RTB subject to certain legal restrictions.

The information in the Management's Discussion & Analysis (MD&A) is not a required part of the financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We did not audit and do not express an opinion on such information. However, we have applied certain limited procedures, which

consisted principally of inquiries of management regarding the methods of measurement and presentation of the MD&A information.

In accordance with *Government Auditing Standards*, we have also issued reports dated October 27, 2005, on our consideration of the RTB's internal control over financial reporting, and on our tests of its compliance with certain provisions of applicable 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.

Gardner Kuyper & Associates

October 27, 2005

Independent Auditor's Report on Internal Control over Financial Reporting

To the Inspector General and the
Rural Telephone Bank Board of Directors

We have audited the financial statements of the Rural Telephone Bank (RTB), an agency of the United States Department of Agriculture, as of, and for the year ended September 30, 2005, and have issued our report thereon dated October 27, 2005. 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, Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*.

In planning and performing our audit, we considered the RTB's internal control over financial reporting by obtaining an understanding of the RTB's internal control, determined whether internal controls had been placed in operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-02 and *Government Auditing Standards*. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982 (FMFIA), such as those controls relevant to ensuring efficient operations. The objective of our audit was not to provide assurance on internal control over financial reporting. 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 reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the RTB's ability to initiate, record, process, and report financial data consistent with the assertions by management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal controls, misstatements due to error or fraud, may occur and not be detected.

However, we noted a certain matter discussed on pages 5 and 6 involving the internal control over financial reporting and its operation that we consider to be a reportable condition. We consider this reportable condition to be a material weakness.

In addition, with respect to internal control related to performance measures reported in the Management's Discussion and Analysis (MD&A), we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, as required by OMB Bulletin No. 01-02. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

This report is intended solely for the information and use of the management of the RTB, Rural Development (RD), United States Department of Agriculture (USDA), Office of the Inspector General (OIG), OMB, and Congress, and is not intended to be and should not be used by anyone other than these specified parties.


October 27, 2005

MATERIAL WEAKNESS

Information Technology (IT) Control Weaknesses Impact the Reliability of Financial Data

IT control weaknesses, which include an unreliable certification and accreditation (C&A) process, and ineffective controls in the Office of the Chief Information Officer-information technology (IT) general control environment have had a material effect on the integrity, confidentiality, and availability of Rural Development's systems and data. These weaknesses need to be addressed at the Department's Office of the Chief Information Officer (OCIO) level to ensure that effective controls are established; however, the weaknesses are significant enough that the reliability of Rural Development's systems and data may be affected. As a result, Rural Development's critical loan portfolio data and information residing on the systems are at risk of compromise impacting the reliability of the financial data.

We recognize the significant commitment and progress accomplished by Rural Development, both independently and through the efforts of the President's Management Agenda, during the fiscal year to implement corrective actions on our prior audit recommendations, and meet the Department's timeframes for completing system C&As. Rural Development has worked closely with OIG to ensure that proposed corrective actions will address the systemic causes of the issues we have previously identified. The Inspector General's Audit Report 85401-12-FM disclosed the following material weakness.

C&A

Required by Office of Management and Budget (OMB) Circular No. A-130, Appendix III, "Security of Federal Automated Information Resources," dated November 30, 2000, security accreditation provides a form of quality control and challenges managers and technical staffs at all levels to implement the most effective security controls possible in an information system, given mission requirements, technical constraints, operational constraints, and cost/schedule constraints. By accrediting an information system, an agency official accepts responsibility for the security of the system and is fully accountable for any adverse impacts to the agency if a breach of security occurs. Thus, responsibility and accountability are core principles that characterize security accreditation.

Rural Development had aggressively pursued accreditation of its major application as required by OMB Circular No. A-130. However, OIG review of the C&A documentation supporting Rural Utilities Service (RUS) Legacy system and RULSS applications disclosed that the documentation did not meet basic accreditation requirements, the security testing and evaluation (ST&E) was inadequate, and/or the systems were fully accredited without restrictions or limitation before all components were fully operational. While Rural Development closely followed the Department's guidance in completing its C&A efforts, the process did not result in complete and reliable documentation, or ensure that adequate testing was performed during the independent ST&E process. As a result, these deficiencies render the accreditation ineffective in meeting the intent of OMB Circular No. A-130.

Information Technology Security

Based on our review of recent USDA OIG evaluations of information technology security and controls, 50501-3-FM, RTB is also not in compliance with OMB Circular A-130 with respect to the information security access controls for the Common Computing Environment which governs the general controls for the Finance Office's Local Area Network, St. Louis, Missouri. However, another recent report by the OIG, 88501-2FM clears findings which we reported last year for the National Information Technology Center (NITC), Kansas City, Missouri.

Based on information from the prior year audit, we noted that the following conditions, which were reported by the OIG in its review of Service Center Agencies (see afore mentioned 50501-3-FM report for details of the findings), are still outstanding:

- Access Controls - RD has begun to implement new controls in this area but still has not implemented "least privilege" access controls. Testing identified users on the ITS network that had access privileges exceeding what they needed to perform in their assigned responsibilities. Until improved controls are fully implemented, data is at risk for disclosure, modification, or deletion, including risks for user identification, authorization, remote access, and password settings.
- Timely Correction of Vulnerabilities - The Information Systems Security Program Manager had started to implement routine scanning and mitigation processes, but RD systems remain unnecessarily vulnerable to exploitation until this is implemented agency-wide.

Additional details and recommendations can be found under separate cover, OIG Audit Report No. 50501-3-FM, "Office of the Chief Information Officer – Management and Security Over Information Technology Convergence – Common Computing Environment," dated October 24, 2005. Since these recommendations are directed at the Department's OCIO, OIG made no recommendations for Rural Development to address.

RECOMMENDATIONS

The OIG has revised prior year recommendations to reflect progress that management has made. OIG recognizes the Department's responsibility to implement effective guidance and controls over the C&A process and has made recommendations to the Department under OIG Audit Report No. 50501-4-FM, "Review of the U.S. Department of Agriculture's Certification and Accreditation Efforts," dated October 21, 2005. As such, we have no additional recommendations at this time.



Independent Auditor's Report on Compliance with Laws and Regulations

To the Inspector General and the
Rural Telephone Bank Board of Directors

We have audited the financial statements of the Rural Telephone Bank (RTB), an agency of the United States Department of Agriculture, as of, and for the year ended September 30, 2005, and have issued our report thereon dated October 27, 2005. 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, Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*.

The management of the RTB is responsible for complying with laws and regulations applicable to the agency. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the RTB's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin No. 01-02, including the requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996. We limited our tests of compliance to these provisions and we did not test compliance with all laws and regulations applicable to the RTB.

The results of our tests of compliance with laws and regulations described in the preceding paragraph exclusive of FFMIA disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 01-02.

Under FFMIA, we are required to report on whether the RTB's financial management systems substantially comply with the Federal financial management systems requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA section 803 (a) requirements.

The results of our tests disclosed instances where RTB's financial management systems did not substantially comply with Federal Financial Management System Requirements (FFMSR) for OMB Circular A-130, "Management of Federal Information Resources." Instances of non-compliance are described on pages 5 and 6.

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion.

This report is intended solely for the information and use of the management of the RTB, Rural Development (RD), United States Department of Agriculture (USDA) Office of the Inspector General (OIG), OMB, and Congress, and is not intended to be and should not be used by anyone other than these specified parties.


October 27, 2005

RURAL TELEPHONE BANK MANAGEMENT'S DISCUSSION AND ANALYSIS (OVERVIEW)

Rural Telephone Bank's Vision for Rural America

Mission and Organizational Structure

The Rural Telephone Bank (RTB) was designed to assure rural telephone systems access to private sources of capital by establishing a supplemental credit mechanism to which borrower systems may turn for all or part of their future capital requirements. Since its inception in 1971, RTB has approved approximately \$4.37 billion, net of rescissions, in loans to rural telecommunications infrastructure.

Ownership of RTB, in addition to the United States Government, consists of borrowers, former borrowers and other related organizations authorized to invest. RTB operates on a cooperative basis and earnings, in excess of the annual return of two percent required on the Government's investment, are returned to the non-government owners.

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

In fiscal year (FY) 2005, RTB financing represented approximately 25 percent of the total loans approved by Rural Development under the telecommunications loan program.

**RURAL TELEPHONE BANK
MANAGEMENT'S DISCUSSION AND ANALYSIS (OVERVIEW)**

Performance Goals and Results

The following performance indicators are calculated based on the percentage of RTB funding provided as a supplement to other Rural Utilities funding:

Performance Indicators	FY 2005 Target	FY 2005 Actual
Number of rural residents and businesses to receive new or improved service as a result of new loan investment	40,924	40,369
Leveraging of private funds	\$.94:1	\$.96:1

The target for the number of rural subscribers receiving new or improved service was not met; however, it was only missed by approximately 1 percent. The leveraging performance measure was met. This performance indicator measures the extent to which borrowers are investing with funds other than RTB funds.

Entity's Financial Statements

Assets remained consistent at \$2.2 billion during the fiscal year.

Entity's Systems, Controls and Legal Compliance

The purpose of the Federal Managers' Financial Integrity Act (FMFIA) is to promote the development of management structures that ensure management accountability for results and include appropriate, cost effective controls. The FMFIA requires annual assurance statements on both management controls and compliance with financial management system requirements.

For fiscal year 2005, Rural Development is reporting that our internal controls and financial management and accounting systems are compliant with Section 2 and Section 4 of the FMFIA Report.

Future Opportunities and Challenges

The President's Fiscal Year 2006 Budget proposes to establish the process and terms to implement a dissolution of the RTB due to insufficient demand for the bank's loans and the availability of adequate financing from other sources. Stockholders of the RTB will receive a cash payout for their stock. In August 2005, the RTB board unanimously approved resolutions describing the process and terms to implement the liquidation and dissolution of the RTB, subject to there being no legal restriction on redeeming Government owned Class A Stock.

**RURAL TELEPHONE BANK
MANAGEMENT'S DISCUSSION AND ANALYSIS (OVERVIEW)**

As of September 30, 2005, stock outstanding totaled \$1.76 billion, including government-owned class A stock of \$368.9 million, and privately-owned class B and C stock of \$480.8 million and \$909.2 million, respectively.

For fiscal year 2005, RTB is reporting no impact on loan investments due to the devastating hurricanes in the Gulf Coast region.

Limitations on Financial Statements

These financial statements have been prepared to report the financial position and results of operations of the entity, pursuant to the requirements of 31 U.S.C. 3515(b). While the statements have been prepared from the books and records of the entity in accordance with the formats prescribed by the Office of Management and Budget, the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records. The statements should be read with the realization that they are a component of the U.S. Government, a sovereign entity. One implication of this is that liabilities cannot be liquidated without legislation that provides resources to do so.

U.S. Department of Agriculture
Rural Telephone Bank
BALANCE SHEET
As of September 30, 2005 and 2004
(in dollars)

	<u>FY 2005</u>	<u>FY 2004</u>
ASSETS		
Assets for Use by Entity:		
Federal		
Fund Balance with Treasury (Note 2)	\$ 1,576,011,359	\$ 1,410,526,048
Interest Receivable (Note 3)	6,050,555	5,800,817
Non-Federal		
Loans Receivable, Net (Note 4)	<u>637,550,680</u>	<u>788,206,343</u>
Total Assets	<u>\$ 2,219,612,594</u>	<u>\$ 2,204,533,208</u>
LIABILITIES		
Liabilities Covered by Budgetary Resources:		
Federal		
Interest Payable	\$ 494,296	\$
Accounts Payable	13,744,115	10,954,015
Debt (Note 5)	335,419,610	343,114,808
Non-Federal		
Other Liabilities (Note 6)	<u>50,267,844</u>	<u>48,779,630</u>
Total Liabilities	<u>399,925,865</u>	<u>402,848,453</u>
COMMITMENTS AND CONTINGENCIES (Note 7)		
NET POSITION		
Unexpended Appropriations (Note 8)	<u>15,939,186</u>	<u>17,959,620</u>
Capital Stock (Note 9)		
Federal		
Equity of the U.S. Government		
Capital Stock Class A	368,861,761	388,275,537
Subsidy Re-estimates	<u>(252,336)</u>	<u>(72,455)</u>
Total Equity of the U.S. Government	368,609,425	388,203,082
Non-Federal		
Investment of Others		
Capital Stock Class B	480,823,650	521,621,555
Capital Stock Class C	909,237,000	821,487,000
Restricted Capital	10,000,000	10,000,000
Patronage Capital Earned	<u>35,077,468</u>	<u>42,413,498</u>
Total Investment of Others	<u>1,435,138,118</u>	<u>1,395,522,053</u>
Cumulative Results of Operations	<u>1,803,747,543</u>	<u>1,783,725,135</u>
Total Net Position	<u>1,819,686,729</u>	<u>1,801,684,755</u>
Total Liabilities and Net Position	<u>\$ 2,219,612,594</u>	<u>\$ 2,204,533,208</u>

The accompanying notes are an integral part of these statements.

U.S. Department of Agriculture
Rural Telephone Bank
STATEMENT OF NET COST
For the Years Ended September 30, 2005 and 2004
(in dollars)

	<u>FY 2005</u>	<u>FY 2004</u>
Program Costs		
Intragovernmental Gross Costs		
Borrowing Interest Expense	\$ 27,101,722	\$ 24,263,120
Operating Expense	<u>3,126,784</u>	<u>3,152,291</u>
Total Intragovernmental Gross Costs	<u>30,228,506</u>	<u>27,415,411</u>
Less: Intragovernmental Earned Revenue (Note 10)	<u>75,477,990</u>	<u>72,828,481</u>
Intragovernmental Net Costs	<u>(45,249,484)</u>	<u>(45,413,070)</u>
Gross Costs with the Public	(2,593,665)	(6,854,510)
Less: Earned Revenues from the Public (Note 10)	<u>48,390,086</u>	<u>50,995,392</u>
Net Costs with the Public	<u>(50,983,751)</u>	<u>(57,849,902)</u>
Net Cost of Operations	<u>\$ (96,233,235)</u>	<u>\$ (103,262,972)</u>

The accompanying notes are an integral part of these statements.

U.S. Department of Agriculture
Rural Telephone Bank
STATEMENT OF CHANGES IN NET POSITION
For the Years Ended September 30, 2005 and 2004
(in dollars)

	<u>FY 2005</u>		<u>FY 2004</u>	
	<u>Cumulative Results of Operations</u>	<u>Unexpended Appropriations</u>	<u>Cumulative Results of Operations</u>	<u>Unexpended Appropriations</u>
Beginning Balance	\$ 1,783,725,135	\$ 17,959,620	\$ 1,753,690,352	\$ 21,282,263
Budgetary Financing Sources:				
Appropriations Received		4,910,122		3,508,716
Appropriations Transferred In/Out				
Other Adjustments		(1,041,555)		(2,185,796)
Appropriations Used	5,889,001	(5,889,001)	4,645,563	(4,645,563)
Transfers In/Out w/o Reimbursement	(9,191,294)		(3,339,410)	
Other Budgetary Financing Sources:				
Redemption of Class A Stock	(19,413,776)		(20,435,554)	
A Stock Dividends	(7,765,510)		(8,174,222)	
C Stock Dividends	(50,267,844)		(48,779,630)	
Investment of Others	4,538,596		2,855,064	
Total Budgetary Financing Sources	(76,210,827)	(2,020,434)	(73,228,189)	(3,322,643)
Net Costs of Operations	96,233,235		103,262,972	
Ending Balances	1,803,747,543	15,939,186	1,783,725,135	17,959,620

The accompanying notes are an integral part of these statements.

U.S. Department of Agriculture
Rural Telephone Bank
STATEMENT OF BUDGETARY RESOURCES
For the Years Ended September 30, 2005 and 2004
(in dollars)

	FY 2005		FY 2004	
	Budgetary	NonBudgetary Credit Program Financing Accounts	Budgetary	NonBudgetary Credit Program Financing Accounts
Budgetary Resources				
Appropriations Received (Note 14)	4,910,122		3,508,716	
Borrowing Authority (Note 12/13)		235,144,814		216,476,539
Net Transfers	(19,413,776)		(20,435,554)	
Unobligated Balances (Note 15)				
Beginning of Period (Brought Forward)	1,290,880,723	30,422,358	1,202,530,590	1,626,149
Spending Authority from Offsetting Collections				
Earned				
Collected	244,014,692	140,999,727	202,823,634	61,452,350
Receivables from Federal Sources	71,358	178,378	(50,656,712)	
Change in Unfilled Customer Orders				
Without Advance from Federal Sources		(18,925)		(2,247,273)
Recoveries of Prior Yr Obligations	15,342,347	68,848,809	15,739,704	76,361,157
Permanently Not Available	(8,807,065)	(179,640,930)	(10,360,018)	(110,543,040)
Total Budgetary Resources	1,526,998,401	295,934,231	1,343,150,360	243,125,882
Status of Budgetary Resources:				
Obligations Incurred (Note 11)				
Direct	55,271,006	214,004,658	52,269,637	212,703,525
Unobligated Balances:				
Apportioned		18,555,622		
Unobligated Balances Not Yet Available	1,471,727,395	63,373,951	1,290,880,723	30,422,358
Total Status of Budgetary Resources	1,526,998,401	295,934,231	1,343,150,360	243,125,882
Relationship of Obligations to Outlays				
Obligated Balance, Net - Beginning of Period	107,247,525	1,205,455,814	53,498,911	1,169,348,641
Obligation Incurred	55,271,006	214,004,658	52,269,637	212,703,525
Less:				
Recoveries of Prior Year Obligations	15,342,347	68,848,809	15,739,704	76,361,157
Changes from Federal Sources	71,358	159,453	(50,656,712)	(2,247,273)
Obligated Balance, Net - End of Period				
Accounts Receivable	(5,872,177)	(178,378)	(5,800,819)	
Undelivered Orders	46,990,083	1,217,322,177	64,268,714	1,205,445,814
Accounts Payable	50,267,844	494,296	48,779,630	
Total, Obligated Balances, Net - End of Period	91,385,750	1,217,638,095	107,247,525	1,205,445,814
Disbursements	55,719,076	132,804,114	33,438,031	102,492,467
Collections and Advances Received	(244,014,692)	(140,999,727)	(202,823,634)	(61,452,350)
Outlays	(188,295,616)	(8,195,613)	(169,385,603)	41,040,117
Less: Offsetting Receipts	10,218,124		11,155,042	
Net Outlays	(198,513,740)	(8,195,613)	(180,540,645)	(41,040,117)

The accompanying notes are an integral part of these statements.

U.S. Department of Agriculture
Rural Telephone Bank
STATEMENT OF FINANCING
For the Years Ended September 30, 2005 and 2004
(in dollars)

	<u>FY 2005</u>	<u>FY 2004</u>
Resources Used To Finance Activities:		
Budgetary Resources Obligated		
Obligations Incurred	\$269,275,664	\$264,973,162
Less: Spending Authority From Offsetting Collections and Recoveries	469,436,386	303,472,860
Obligations Net of Offsetting Collections and Recoveries	<u>(200,160,722)</u>	<u>(38,499,698)</u>
Less: Offsetting Receipts	10,218,124	11,155,042
Total Resources Used To Finance Activities	<u>(210,378,846)</u>	<u>(49,654,740)</u>
Resources Used To Finance Items Not Part Of The Net Costs Of Operations:		
Change in Budgetary Resources Obligated For Goods, Services, and Benefits Ordered But Not Yet Provided	(5,402,267)	18,593,516
Resources That Fund Expenses Recognized in Prior Periods	1,700,769	320,953
Budgetary Offsetting Collections and Receipts That Do Affect Net Costs of Operations		
Credit Program Collections Which Increase Liabilities for Loan Guarantees or Allowance for Subsidy	(385,264,155)	(213,619,273)
Other	(10,218,124)	(11,155,042)
Resources That Finance the Acquisition of Assets	184,616,699	151,880,497
Total Resources Used to Finance Items Not Part of The Net Cost of Operations	<u>(214,567,078)</u>	<u>(53,979,349)</u>
Total Resources Used to Finance the Net Cost of Operations	<u>4,188,232</u>	<u>4,324,609</u>
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:		
Upward/Downward Reestimates of Credit Subsidy Expense (Note 16)	(7,310,645)	(8,220,231)
Other	(93,196,304)	(99,127,798)
Total Components of Net Cost of Operations That Will Require or Generate Resources in Future Periods	(100,506,949)	(107,348,029)
Components Not Requiring or Generating Resources		
Depreciation and Amortization		
Other	85,482	(239,552)
Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period	<u>(100,421,467)</u>	<u>(107,587,581)</u>
Net Costs of Operations	<u>(\$96,233,235)</u>	<u>(\$103,262,972)</u>

The accompanying notes are an integral part of these statements.

RURAL TELEPHONE BANK
NOTES TO THE FINANCIAL STATEMENTS

NOTE 1: SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The Rural Telephone Bank (RTB), established in May 1971, provides a supplemental source of financing under the rural utilities telephone loan program. As part of the United States Department of Agriculture (USDA), Rural Development assists rural electric and telephone organizations in obtaining the financing required to provide electric and telephone service in rural areas. RTB lends principally to rural telephone organizations.

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

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

B. Basis of Presentation

The accompanying financial statements have been prepared to report the financial position, net costs, and changes in net position of RTB as required by the Government Management Reform Act of 1994, and in conformity with generally accepted accounting principles (GAAP). GAAP for Federal financial reporting entities recognize the Federal Accounting Standards Advisory Board (FASAB) as the standards-setting body designated to establish these principles for these entities. The financial statements have also been prepared from the books and records of RTB in accordance with the form and content for entity financial statements specified by the Office of Management and Budget (OMB) Circular No. A-136, Financial Reporting Requirements, with additional presentation disclosures to encompass RTB's unique business processes.

C. Basis of Accounting

RTB's transactions are recorded on the accrual basis of accounting and with respect to certain information regarding budgetary resources and financing, a budgetary accounting basis. Under the accrual method, revenues are recognized when earned, and expenses are recognized when a liability is incurred. Budgetary accounting is also necessary to facilitate compliance

**RURAL TELEPHONE BANK
NOTES TO THE FINANCIAL STATEMENTS**

with legal constraints and controls over the use of Federal funds. Any significant interfund and intrafund balances and transactions have been eliminated in the consolidation of the pre- and post-credit reform lending programs.

D. Fund Balance with Treasury

RTB maintains all cash accounts with the United States (U.S.) Treasury. It is the policy of RTB not to maintain cash in commercial bank accounts, except in the normal course of processing cash receipts through third-party commercial banking institutions. Fund Balance with Treasury represents appropriated and revolving funds that are available to pay current liabilities and finance authorized loan commitments. RTB earns interest on all cash balances maintained at the U.S. Treasury in accordance with the terms of the 1973 note executed by RTB and U.S. Treasury, Section 505(c) of the Federal Credit Reform Act of 1990 and legislation (Public Law 106-78).

E. Loans Receivable, Net

Loans are accounted for as receivables after funds are disbursed. Loans receivable are carried at the principal amount outstanding, net of an allowance for estimated uncollectible amounts for pre-fiscal year (FY) 1992 loans. For direct loans obligated on or after October 1, 1991, RTB recognizes these assets at the present value of their estimated net cash inflows. The difference between the outstanding principal of the loans and the present value of their net cash inflows is recognized as a subsidy cost allowance (Note 4). All loan receivables are due from non-Federal borrowers and accrue interest daily based on the contractual interest rate.

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

Due to accelerated reporting requirements, a reestimate approximator method was implemented in FY 2003. Actual budgetary reestimates, as of September 30, 2005, will be completed during FY 2006.

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

**RURAL TELEPHONE BANK
NOTES TO THE FINANCIAL STATEMENTS**

F. Liabilities

Liabilities are recognized for amounts of probable future outflows or other sacrifices of resources as a result of past transactions or events. Since RTB is a component of the U.S. Government, a sovereign entity, its liabilities cannot be liquidated without legislation that provides resources to do so. Payments of all liabilities other than contracts can be abrogated by the sovereign entity.

Liabilities Covered by Budgetary Resources are those liabilities funded by available budgetary resources including: (1) new budget authority, (2) spending authority from offsetting collections, (3) recoveries of unexpired budget authority, (4) unobligated balances of budgetary resources at the beginning of the year, and (5) permanent indefinite appropriation or borrowing authority. All of RTB's liabilities are covered by budgetary resources.

- **Interest Payable**

Interest payable consists solely of amounts owed to the U.S. Treasury on borrowed funds.

- **Accounts Payable**

Accounts payable consist solely of amounts payable to the U.S. Treasury based on credit reform subsidy reestimates.

- **Debt**

As required under Credit Reform legislation, a note was executed by RTB with the U.S. Treasury that provides funds for direct loans approved after September 30, 1991 (Post-1991). The interest rate charged to RTB is the average annual U.S. Treasury rate, as provided by OMB. For loans approved prior to October 1, 1991 (Pre-1992), U.S. Treasury funding is provided, when needed, in accordance with the terms of a note executed by RTB and U.S. Treasury in July 1973. RTB has not borrowed against the note for several years since the pre-1992 fund balance is sufficient to advance new loans.

G. Stock Conversion

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

**RURAL TELEPHONE BANK
NOTES TO THE FINANCIAL STATEMENTS**

H. Operations

The Rural Electrification (RE) Act of 1936, as amended, and RTB's enabling legislation, authorize RTB to partially or jointly use the facilities and services of employees of Rural Development, or of any other agency of the USDA, without cost. Under the Federal Credit Reform Act, \$3,126,784 of appropriated funds provided to RTB to cover administrative costs was transferred to Rural Development for FY 2005. This amount represents the additional cost to Rural Development for managing RTB. In this regard, RTB's operations are conducted by Rural Development administrative and program employees who have similar responsibilities under Rural Development's rural telephone loan program.

I. Intra-Governmental Relationships and Transactions

In the course of its operations, RTB has relationships and financial transactions with other Federal agencies. The more prominent of these are with Rural Development and the U.S. Treasury. Rural Development determines the annual cost allocations associated with the administration of RTB by Rural Development employees, and the U.S. Treasury receives the collections of proceeds from direct loans issued on behalf of RTB.

J. Future Considerations

Proposed Dissolution of the Rural Telephone Bank

The President's Fiscal Year 2006 Budget proposes to establish the process and terms to implement dissolution of the RTB due to insufficient demand for the Bank's loans and the availability of adequate financing from other sources. Stockholders of the RTB will receive a cash payout for their stock at par value. In August 2005, the RTB Board unanimously approved resolutions describing the process and terms to implement the liquidation and dissolution of the RTB, subject to there being no legal restriction on redeeming Government-owned Class A Stock. Additional information on stock owned by borrowers and third parties is reported in **Note 9**.

**RURAL TELEPHONE BANK
NOTES TO THE FINANCIAL STATEMENTS**

NOTE 2: FUND BALANCE WITH TREASURY

Amounts presented in dollars.

	FY 2005		FY 2004
Fund Balances:			
Revolving Funds	\$1,560,072,173		\$1,392,566,428
Appropriated Funds	15,939,186		17,959,620
Total	\$1,576,011,359		\$1,410,526,048

	FY 2005		FY 2004
Unobligated Balance			
Unavailable, end of year *	\$1,515,989,414		\$1,333,482,500
Unavailable, restricted	133,647		299,934
Available	0		77,101
Obligated Balance			
Not Yet Disbursed	59,888,298		76,666,513
Total	\$1,576,011,359		\$1,410,526,048

*Amount becomes available through the Standard Form (SF) 132 process.

NOTE 3: INTEREST RECEIVABLE

Amounts presented in dollars.

	FY 2005		FY 2004
Intragovernmental			
Due from U.S. Treasury	\$ 6,050,555		\$ 5,800,817

In FY 2005 and FY 2004, U.S. Treasury interest was based on the average fund balance on deposit with the U.S. Treasury as of August 31, 2005 and August 31, 2004, respectively, and received in current fiscal year business. A receivable was calculated for the months of September and included in this year's and last year's balance sheet, respectively, and will be received in FY 2006 and FY 2005, respectively.

**RURAL TELEPHONE BANK
NOTES TO THE FINANCIAL STATEMENTS**

NOTE 4: LOANS RECEIVABLE, NET

Purpose

The Rural Telephone Bank (RTB) was created by Public Law 92-12 on May 7, 1971. The RTB was designed to assure rural telephone systems access to private sources of capital. It did this by establishing a supplemental credit mechanism to which borrower systems may turn for all or part of their future capital requirements. The RTB is owned by the U.S. Government, its borrowers, former borrowers, and other related organizations authorized to invest. The RTB operates on a cooperative basis and earnings, in excess of the annual return of 2 percent required on the Government's investment, are returned to the non-Government owners as patronage refunds.

RTB makes telecommunications loans to public bodies, cooperative, nonprofit, limited association or mutual associations. RTB loans are made concurrently with Rural Development cost-of-money loans to finance the improvement, expansion, construction, and acquisition of systems or facilities that improve telephone service in rural areas. However, RTB does not finance station apparatus owned by the borrower, headquarters' facilities, and vehicles not used primarily in construction.

Eligibility

To be eligible, a borrower must be incorporated and must provide or propose to provide the basic local exchange telephone service needs of rural areas. A borrower must demonstrate that the average number of proposed subscribers per mile of line in the service area of the borrower is less than or equal to 15, or the borrower has a projected Times Interest Earned Ratio (borrowers net income after taxes plus interest expense, all divided by interest expense) of at least 1.0 but not greater than 5.0. Additionally, the borrower must participate in an approved telecommunications modernization plan for the state.

Repayment Period and Interest Rates

Loans must be repaid within a period that approximates the expected useful life of the facilities to be financed, not to exceed 35 years. Generally, interest is payable each month as it accrues. Principal payments on each note generally are scheduled to begin 2 years after the date of the note. After this deferral period, interest and principal payments on all funds advanced during this 2-year period are scheduled in equal monthly installments. RTB loans will bear interest at a rate equal to the cost of funds to RTB. However, the rate will not be less than 5 percent.

**RURAL TELEPHONE BANK
NOTES TO THE FINANCIAL STATEMENTS**

Servicing Options

RTB may extend the time of payment of principal or interest on a loan. This extension may be up to 5 years after such payment is due. Payment may be deferred as long as necessary in disaster situations so long as the final maturity date is not later than 40 years after the date of the loan.

Accounting Policy

Direct loan obligations made prior to FY 1992 are reported on a net realizable value basis. Direct loan obligations made after FY 1991 are governed by the Federal Credit Reform Act. The Act provides that the present value of the subsidy costs (i.e., interest rate differentials, interest subsidies, delinquencies and defaults, fee offsets and other cash flows) associated with direct loans be recognized as a cost in the year the loan is made. The net present value of loans receivable at any point in time is the amount of the gross loan receivable less the present value of the subsidy at that time.

Economic Factors and Outlook Affecting Subsidy Reestimates

The RTB subsidy rate is supported by three components to include interest rate, defaults, and prepayments. The interest rate component is the only sensitive component and there have been no defaults in this program.

The reestimate amounts have been minimal with the FY 2004 actual budgetary reestimates resulting in a \$8 million downward reestimate (net) decreasing program funding requested at time of formulation. With the borrower rate being approximated by the U.S. Treasury rate at the time of advancing funds, interest subsidy rate increases have been significant. Currently, there are no foreseeable events that may require significant additional subsidy.

Direct Loans Obligated Prior to FY 1992
(Allowance for Loss Method):

Amounts presented in dollars.

	FY 2005		FY 2004
Loans Receivable, Gross	\$ 274,062,427		\$ 423,503,887
Interest Receivable	\$ 586,124		\$ 1,008,091
Allowance for Loan Losses	\$ (4,006,818)		\$ (3,921,333)
Value of Assets Related to Direct Loans	\$ 270,641,733		\$ 420,590,645

RURAL TELEPHONE BANK
NOTES TO THE FINANCIAL STATEMENTS

Direct Loans Obligated After FY 1991
(Present Value Method)

Amounts presented in dollars.

	FY 2005		FY 2004
Loans Receivable, Gross	\$ 355,507,722		\$ 363,676,369
Interest Receivable	\$ 577,802		\$ 245,037
Allowance for Subsidy Cost (Present Value)	\$ 10,823,423		\$ 3,694,292
Value of Assets Related to Direct Loans	\$ 366,908,947		\$ 367,615,698
Total Portfolio Value of Assets Related To Direct Loans	\$ 637,550,680		\$ 788,206,343

Total Amount of Direct Loans Disbursed:

Amounts presented in dollars.

	FY 2005		FY 2004
Direct Loans Obligated Prior to FY 1992	\$ 1,185,713		\$ 854,337
Direct Loans Obligated After FY 1991	\$ 91,416,689		\$ 63,881,123

Subsidy Expense for Direct Loans by Program and Component:

Amounts presented in dollars.

Subsidy Expense for New Direct Loans Disbursed

	FY 2005		FY 2004
Interest Differential	\$ (476,439)		\$ 970,454
Defaults	\$ 19,661		\$ 19,407
Other	\$ (56,798)		\$ 153,020
Total	\$ (513,576)		\$ 1,142,881

**RURAL TELEPHONE BANK
NOTES TO THE FINANCIAL STATEMENTS**

Reestimates

	FY 2005		FY 2004
Interest Rate Reestimates	\$ (611,719)		\$ (10,884,876)
Technical Reestimates	\$ (5,181,255)		\$ 2,677,319
Total	\$ (5,792,974)		\$ (8,207,557)
Total Direct Loan Subsidy Expense:	\$ (6,306,550)		\$ (7,064,676)

Budget Subsidy Rates for Direct Loans by Program and Component

	FY 2005		FY 2004
Interest Differential	(1.43)%		(4.29)%
Defaults	.02 %		0.02%
Other Collections	(.42)%		(0.05)%
Total	(1.83)%		(4.32)%

RURAL TELEPHONE BANK
NOTES TO THE FINANCIAL STATEMENTS

Subsidy Rates for Direct Loans by Program and Component:

Schedule for Reconciling Subsidy Cost Allowance Balances:
(Post- FY 1991 Direct Loans)

Amounts presented in dollars.

Beginning Balances, Changes, and Ending Balances	FY 2005	FY 2004
Beginning balance of the subsidy cost allowance:	\$ (3,694,292)	\$ 2,264,455
Add: subsidy expense for direct loans disbursed during the reporting years by component:		
(a) Interest rate differential costs	(476,439)	970,454
(b) Default costs (net of recoveries)	19,661	19,407
(c) Fees and other collections	(56,798)	153,020
Total of the above subsidy expense and components	\$ (513,576)	\$ 1,142,881
Adjustment:		
(a) Subsidy allowance amortization	(822,581)	1,105,929
Ending balance of the subsidy cost allowance before reestimate	\$ (5,030,449)	\$ 4,513,265
Add or subtract subsidy reestimates by component:		
(a) Interest rate reestimate	(611,719)	(10,884,876)
(b) Technical/default reestimate	(5,181,255)	2,677,319
Total of the above reestimate components	\$ (5,792,974)	\$ (8,207,557)
Ending balance of the subsidy cost allowance	\$(10,823,423)	\$ (3,694,292)

	FY 2005	FY 2004
Administrative Expense	\$ 3,126,784	\$ 3,152,291

**RURAL TELEPHONE BANK
NOTES TO THE FINANCIAL STATEMENTS**

NOTE 5: DEBT

Amounts presented in dollars.

	FY 2005		
	Beginning Balance	Net Borrowings	Ending Balance
Federal Debt			
Interest Bearing:			
Debt to the U.S. Treasury	\$ 343,114,808	(7,695,198)	\$ 335,419,610

	FY 2004		
	Beginning Balance	Net Borrowings	Ending Balance
Federal Debt			
Interest Bearing:			
Debt to the U.S. Treasury	\$ 300,996,852	42,117,956	\$ 343,114,808

Legislation limits outstanding borrowings from the U.S. Treasury to an amount, which shall not exceed twenty times RTB's equity. As of September 30, 2005 and 2004, RTB's maximum borrowing authority approximated \$36 billion. All Federal debt is covered by budgetary resources.

NOTE 6: OTHER LIABILITIES

Dividends are declared on Class C stock to non-federal recipients with approval by the RTB Board. For FY 2005, the final stock dividend percentage requires RTB Board consideration and is estimated at the maximum allowed for financial statement purposes. The C stock payable for September 30, 2004, was \$48.8 million and for September 30, 2005, was estimated at \$50.3 million.

Dividends are paid in December of the same calendar year. This liability is covered by budgetary resources.

**RURAL TELEPHONE BANK
NOTES TO THE FINANCIAL STATEMENTS**

NOTE 7: COMMITMENTS AND CONTINGENCIES

The RTB has in the course of its loan making activities, unliquidated loan obligations that, in the absence of contractual violations or cancellations, will require disbursements. Unliquidated loan obligations at September 30, 2005 and 2004, total approximately \$1,266 million and \$1,270 million, respectively.

As of September 30, 2005 and 2004, there were no obligations due to canceled appropriations for which there is a contractual commitment for payment.

NOTE 8: UNEXPENDED APPROPRIATION

Amounts presented in dollars.

	FY 2005		FY 2004
Unexpended appropriations			
Unobligated	\$ 133,647		\$ 377,035
Undelivered orders	15,805,539		17,582,585
Total Unexpended Appropriations	\$ 15,939,186		\$ 17,959,620

Unexpended appropriations include the undelivered orders and unobligated balances of the program accounts, which receive Congressional appropriations through the budgetary process.

As appropriated funds incur obligations, the obligated amount is recorded as an undelivered order. Undelivered orders are reduced by either an expenditure or an obligation cancellation. Appropriated funds, which are not obligated, are treated as unobligated amounts. Unobligated appropriations are returned to the U.S. Treasury when their period of availability expires.

**RURAL TELEPHONE BANK
NOTES TO THE FINANCIAL STATEMENTS**

NOTE 9: CAPITAL STOCK

Amounts presented in dollars.

	FY 2005		FY 2004
A summary of the RTB capital stock structure follows:			
CAPITAL STOCK CLASS A (\$1 par value)			
Shares authorized	600,000,000		600,000,000
Shares issued and outstanding	368,861,761		388,275,537
Cash dividends	\$ 7,765,510		\$ 8,174,222
CAPITAL STOCK CLASS B (\$1 par value)			
Shares authorized	Unlimited		Unlimited
Shares issued and outstanding	480,823,650		521,621,555
Stock dividends (distributed 12/04 and 12/03)	42,413,498		62,504,042
CAPITAL STOCK CLASS C (\$1,000 par value)			
Shares authorized	Unlimited		Unlimited
Par Value, shares issued and outstanding	909,237,000		821,487,000
Cash dividends (accrued 09/05 and 09/04)	\$ 50,267,844		\$ 48,779,630

Capital Stock Class A

Public Laws 92-12 and 97-98 authorized Congress, in FY's 1971 through 1991, to appropriate no more than \$30 million per year for the purchase of RTB Class A stock. The law provides that Congress annually appropriate funds until such purchases approximate \$600 million. As of September 30, 2005, RTB Class A stock appropriations amounted to approximately \$592.1 million, the total funding Rural Development will receive from Congress. Beginning in 1996, RTB was required to repurchase this stock; however, in accordance with Public Law 106-78, Section 718, the maximum Class A stock that may be retired is 5 percent. According to enabling legislation and amendments, the Bank will be converted to independent status when 51 percent of the Class A stock issued to the United States has been fully redeemed and retired.

On September 30, 2005 and 2004, in accordance with Bank Board resolution 2005-6 and 2004-1, the tenth and ninth redemption's of Class A stock, in the amounts of \$19.4 million and \$20.4 million occurred, leaving balances of \$368.9 million and \$388.3 million outstanding, respectively.

RURAL TELEPHONE BANK
NOTES TO THE FINANCIAL STATEMENTS

Class A stock has a guaranteed annual dividend of 2 percent of the total funds received. Although Rural Development owns all Class A stock on behalf of the U. S. Government, the cash dividends are paid to the U.S. Treasury.

Capital Stock Class B

Class B stock, a voting class of stock, is issued only to borrowers of RTB, in proportion to actual loan advances. RTB requires borrowers to purchase Class B stock in the amount of 5 percent of advanced loan amounts. RTB may not pay cash dividends on Class B stock. Rather, holders of Class B stock are entitled to patronage refunds (paid in the form of Class B stock dividends) equal to the amount of patronage capital in excess of \$10 million. Patronage refunds are allocated on liquidating account loans, based on the ratio of interest revenue to RTB from each holder to RTB's total interest revenue from all liquidating account Class B stockholders. Stock subscriptions relating to unadvanced loans approximated \$60 million for both September 30, 2005, and 2004, and are not reflected in the accompanying principal financial statements.

Class B stock is nontransferable, except in connection with a transfer of ownership approved by RTB, of all or part of a RTB loan. Class B stock can be redeemed only after all shares of Class A stock, a nonvoting class of stock owned by the U.S. Government, have been redeemed and retired. A borrower may exchange Class B stock for Class C stock: 1) upon retiring all debt with RTB; or 2) effective November 9, 1999, prior to retiring all debt on a proportionate basis equal to the percentage of each note repaid. As of September 30, 2005, and 2004, B stock exchanges of \$269.3 million and \$239.9 million respectively, under the latter method have occurred.

Capital Stock Class C

Class C stock, a voting class of stock, is issued only to RTB borrowers, or to corporations and public entities eligible to borrow from RTB under Section 408 of the RE Act as amended, or by organizations controlled by such borrowers, corporations, and public entities. RTB may pay cash dividends on Class C stock.

Restricted Capital

The Omnibus Budget Reconciliation Act of 1987 required the RTB to establish a contingency reserve or interest rate fluctuations. As a result, the RTB Board of Directors amended the bylaws of RTB regarding the allocation of patronage capital and established a reserve of \$10 million. Any amounts in the reserve for interest rate fluctuations, classified as Restricted Capital on the Balance Sheet, in excess of \$10 million will be allocated as Class B stock dividends to those borrowers holding Class B stock during the fiscal year the amounts were earned. At September 30, 2005 and 2004, Restricted Capital was \$10 million.

Patronage Capital Earned

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

**RURAL TELEPHONE BANK
NOTES TO THE FINANCIAL STATEMENTS**

- Pay expenses of the RTB, including without limitation, payments in lieu of property taxes.
- Pay interest on telephone debentures accruing during the fiscal year.
- Provide reasonable allowances for depreciation, obsolescence, and losses on loans and interest receivable.
- Pay to the holders of Class A stock an amount equal to 2 percent per annum of the capital furnished to the RTB for such stock.
- Pay to the holders of Class C stock dividends at the rate determined by the Board, provided the following criteria is met:
 - No dividends shall be declared on Class C stock until arrearages, if any, on payments to holders of the cumulative Class A stock have been paid.
 - Until all Class A stock has been retired, the Board shall not declare any dividends on Class C stock at an annual rate in excess of the then current average rate payable on the RTB's telephone debentures.

Cumulative Results of Operations

Cumulative Results of Operations are allocated to the various components of Net Position based on the requirements of the RE Act. Specifically, current year results of operations are recorded as Patronage Capital Earned and redistributed to the Class B stock and Restricted Capital accounts. Cash dividends are paid out of Cumulative Results of Operations.

NOTE 10: EARNED REVENUES

Amounts presented in dollars.

	FY 2005		FY 2004
Intragovernmental Earned Revenue			
Interest Revenue from U.S. Treasury	\$ 75,477,990		\$ 72,828,481
Earned Revenue from the Public			
Interest and Penalties Revenue	48,390,086		50,995,392
Total Earned Revenues	\$ 123,868,076		\$ 123,823,873

RURAL TELEPHONE BANK
NOTES TO THE FINANCIAL STATEMENTS

NOTE 11: APPORTIONMENTS CATEGORIES OF OBLIGATIONS INCURRED

Direct obligations incurred as of September 30, 2005 and 2004, is approximately \$214 million and \$213 million, respectively. For FY 2005, \$182 million was apportioned for direct loans and \$33 million was apportioned for U.S. Treasury interest expense and reestimates; and for FY 2004, \$170 million was apportioned for direct loans and \$43 million was apportioned for U.S. Treasury interest expense and reestimates.

NOTE 12: AVAILABLE BORROWING/CONTRACT AUTHORITY, END OF PERIOD

The amount of Federal borrowing authority available as of September 30, 2005 and 2004, is approximately \$1,287 million and \$1,302 million, respectively.

NOTE 13: TERMS OF BORROWING AUTHORITY USED

Requirements for repayments of borrowings: Borrowings are repaid on SF 1151, Nonexpenditure Transfers, as maturity dates become due. For liquidating accounts, maturity dates are fifty years from the close of the fiscal year the funds were advanced by the U.S. Treasury to the Bank. For financing accounts, maturity is based on the period of time used in the subsidy calculation, not the contractual term of the Agency's loans to borrowers. This period of time used in the subsidy calculation will normally be longer than the contractual term of the agency's loans to borrowers.

Terms of borrowings used: In general, borrowings are for periods of up to fifty years depending upon the cohort. Interest rates on borrowings in the liquidating accounts were assigned on the basis of the U.S. 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 U.S. Treasury rate in effect at the end of the year of loan disbursements. Since individual loans are typically disbursed over several years, several interest rates may be applicable to an individual loan. A single weighted average interest rate, which is adjusted each year until all the disbursements for the cohort have been made, is maintained. Prepayments can be made on U.S. Treasury borrowings in the liquidating and financing accounts without penalty.

Financing sources for repayments of borrowings: Included are reestimates and cash flows (i.e. borrower loan principal repayments), appropriations received in liquidating accounts for

**RURAL TELEPHONE BANK
NOTES TO THE FINANCIAL STATEMENTS**

“cash needs,” residual unobligated balances, where applicable, and other U.S. Treasury borrowings.

NOTE 14: PERMANENT INDEFINITE APPROPRIATIONS

Permanent indefinite appropriations are mainly applicable to liquidating accounts which have the ability to apportion them and for reestimates related to upward adjustments of subsidy in the program accounts. These appropriations become available pursuant to standing provisions of law without further action by Congress after transmittal of the Budget for the year involved. They are treated as permanent the first year they become available, as well as succeeding years. However, they are not stated as specific amounts but are determined by specific variable factors, such as “cash needs” for the liquidating accounts and information about the actual performance of a cohort or estimated changes in future cash flows of the cohort in the program accounts.

The period of availability for these appropriations is as follows: Annual authority is available for obligations only during a specific year and expires at the end of that time; Multi-year authority is available for obligations for a specified period of time in excess of one fiscal year; and 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 “canceled.” Therefore, the authority is not available for any purpose.

NOTE 15: LEGAL ARRANGEMENTS AFFECTING USE OF UNOBLIGATED BALANCES

- *Legal arrangements affecting the use of unobligated balances of budget authority:* The availability/use of budgetary resources (i.e., unobligated balances) for obligation and expenditure are limited by purpose, amount, and time.
- *Purpose:* Funds may be obligated and expended only for the purposes authorized in appropriations acts or other laws.

**RURAL TELEPHONE BANK
NOTES TO THE FINANCIAL STATEMENTS**

- *Amount:* Obligations and expenditures may not exceed the amounts established in law. Amounts available are classified as either definite (i.e., not to exceed a specified amount) or indefinite (i.e., amount is determined by specified variable factors).
- *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 14).

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

NOTE 16: EXPLANATION OF DIFFERENCES BETWEEN THE STATEMENT OF BUDGETARY RESOURCES (SBR) AND THE BUDGET OF THE UNITED STATES GOVERNMENT

The 2007 Budget of the United States Government, with the Actual Column completed for FY 2005, 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 2006. The 2006 Budget of the United States Government, with the Actual Column completed for FY 2004, was published in February 2005 and reconciled to the SBR. No reporting errors or differences were noted.

Reconciliation Between FY 2004 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
Total Budgetary Resources (line 7)	\$1,586	Total budgetary resources available for obligation	\$1,586
Total Status of Budgetary Resources (line 11)	\$1,586	Total new obligations, Unobligated balance expiring/withdrawn, Unobligated balance carried forward, end of year, and Unobligated balance available, end of year	\$1,586
Outlays (line 15)	(\$128)	Outlays	(\$128)

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NOTE 17: EXPLANATION OF RELATIONSHIP BETWEEN LIABILITIES NOT COVERED BY BUDGETARY RESOURCES ON THE BALANCE SHEET AND THE CHANGE IN COMPONENTS REQUIRING OR GENERATING RESOURCES IN FUTURE PERIODS ON THE STATEMENT OF FINANCING

Components requiring or generating resources in future periods represent upward/downward reestimates of credit subsidy expense. These subsidy reestimates are recognized expenses even though budgetary resources will be provided in a subsequent period. These credit subsidy reestimates are reported as liabilities covered by budgetary resources since the budget authority to fund the reestimates is permanent and indefinite and no further congressional action is required to provide the resources.