

DEPARTMENT OF AGRICULTURE**Rural Utilities Service****7 CFR Part 1773**

RIN 0572-AA93

Policy on Audits of RUS Borrowers

AGENCY: Rural Utilities Service, USDA.

ACTION: Final rule.

SUMMARY: The Rural Utilities Service (RUS) hereby amends its regulations on audits of RUS borrowers. This final rule incorporates changes to the audit regulations necessitated by the Single Audit Act Amendments of 1996 and by Office of Management and Budget (OMB) Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations effective for audits of fiscal years beginning after June 30, 1996. This rule also clarifies the peer review requirements in the interim final rule for certified public accountants (CPA) performing audits of RUS borrowers, adopts individual management letters for electric and telecommunications borrowers, and revises the language of the auditor's report and management letter to conform with technical guidance provided by the American Institute of Certified Public Accountants (AICPA).

EFFECTIVE DATE: July 17, 1998.

FOR FURTHER INFORMATION CONTACT: Mr. Richard C. Annan, Chief, Technical Accounting and Auditing Staff, Program Accounting Services Division, Rural Utilities Service, Stop 1523, room 2221, South Building, U.S. Department of Agriculture, 1400 Independence Avenue, SW, Washington, DC 20250-1523, telephone number (202) 720-5227.

SUPPLEMENTARY INFORMATION:**Executive Order 12866**

This final rule has been determined to be not significant for the purposes of Executive Order 12866 and therefore has not been reviewed by OMB.

Civil Justice Reform

This final rule has been reviewed under Executive Order 12998, Civil Justice Reform. RUS has determined that this final rule meets the applicable standards provided in section 3 of the Executive Order.

Regulatory Flexibility Act Certification

The Administrator of RUS has determined that this rule will not have significant impact on a substantial number of small entities defined in the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), and therefore, the Regulatory

Flexibility Act does not apply to this rule.

Information Collection and Recordkeeping Requirements

The reporting and recordkeeping requirements contained in this final rule will be submitted for approval to the Office of Management and Budget (OMB) pursuant to the Paperwork Reduction Act of 1995 (44 U.S.C. Chapter 34, as amended) under control number 0572-0095. The paperwork contained in this rule will not be effective until approved by OMB.

Send questions or comments regarding this burden or any aspect of this collection, including suggestions for reducing the burden to Mr. F. Lamont Heppe, Jr., Director, Program Development and Regulatory Analysis, Rural Utilities Service, Stop 1522, 1400 Independence Avenue SW, Washington, DC 20250-1522.

National Environmental Policy Act Certification

The RUS Administrator has determined that this final rule will not significantly affect the quality of the human environment as defined by the National Environmental Policy Act of 1969 (42 U.S.C. 4321 *et seq.*). Therefore, this action does not require an environmental impact statement or assessment.

Catalog of Federal Domestic Assistance

The program described by this final rule is listed in the Catalog of Federal Domestic Assistance Programs under numbers 10.850—Rural Electrification Loans and Loan Guarantees, 10.851—Rural Telephone Loans and Loan Guarantees, and 10.852—Rural Telephone Bank Loans. This catalog is available on a subscription basis from the Superintendent of Documents, the United States Government Printing Office, Washington, DC 20402.

Executive Order 12372

This final rule is excluded from the scope of Executive Order 12372, Intergovernmental Consultation. A notice of final rule entitled Department Programs and Activities Excluded from Executive Order 12372 (50 FR. 47034) exempts RUS electric loans and loan guarantees from coverage under this order.

National Performance Review

This regulatory action is being taken as part of the National Performance Review program to eliminate unnecessary regulations and improve those that remain in force.

Unfunded Mandates

This rule contains no Federal Mandates (under the regulatory provision of Title II of the Unfunded Mandate Reform Act) for State, local, and tribal governments or the private sector. Thus this rule is not subject to the requirements of section 202 and 205 of the Unfunded Mandate Reform Act.

Background

This final rule implements the changes required by the Single Audit Act Amendments of 1996 (31 U.S.C. 7501 *et seq.*) and the revised OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations (31 U.S.C. 7501 *et seq.*). The purposes of the Single Audit Act Amendments of 1996 were to promote sound financial management with respect to Federal awards administered by non-Federal entities, establish uniform requirements for audits of Federal awards, promote the efficient and effective use of audit resources, and reduce the burden on State and local governments, Indian tribes, and non-profit organizations. OMB Circular A-128, Audits of States and Local Governments, was merged with the former OMB Circular A-133, Audits of Institutions of Higher Education and Other Non-Profit Institutions, to form the revised OMB Circular A-133. The revised Circular implements the Single Audit Act Amendments of 1996 and raises the expenditure threshold. The Circular requires auditors to issue a report on compliance and on internal control over financial reporting and a report on compliance with requirements applicable to each major program and internal control over compliance in accordance with OMB Circular A-133.

Previously, separate reports were issued on compliance and internal controls. With the issuance of the revised Circular A-133, the AICPA developed illustrative report examples that merged the two reports into one report on compliance and on internal control over financial reporting.

On January 3, 1996, RUS published 61 FR 104 an interim final rule with request for comments amending part 1773 to comply with the 1994 revision of Generally Accepted Government Auditing Standards (GAGAS) and Statement on Auditing Standards (SAS) No. 74, Compliance Auditing Considerations in Audits of Governmental Entities and Recipients of Governmental Financial Assistance. The January 3, 1996, interim final rule also amended RUS' peer review requirements to reflect the merger of the Private Companies Practice Section of

the AICPA and the AICPA quality review program and to extend the time period for peer reviews to 42 months. This final rule amends part 1773 in response to the comments filed on the interim final rule.

Section 1773.34, Management Letter, specifies the minimum requirements for the CPA's management letter. Among these is the requirement for the CPA to state whether the information submitted to RUS in its most recent December 31 RUS Form 7, Financial and Statistical Report; Form 12, Operating Report—Financial; or Form 479, Financial and Statistical Report for Telephone Borrowers, is in agreement with the borrower's records. This final rule clarifies that section to require the CPA's statement to indicate whether the most recent December 31 RUS Form 7, 12, or 479, agrees with the borrower's "audited" records if a borrower has a December 31 year end. For borrowers with a year end other than December 31, the CPA must state whether the information provided appears reasonable based upon the audit procedures performed.

The management letter for electric borrowers was also modified to conform with changes in § 1717.612, which states that funds are cash proceeds from loans made or guaranteed by RUS; § 1717.618 to redefine "substantially all" in management, operation, or maintenance contracts covering the borrower's system as being 90 percent; and § 1717.609 to delete the provision requiring the CPA to determine whether RUS approval was obtained for contracts between the borrower and its manager.

The management letter for telecommunications borrowers was changed to include additional requirements for compliance with RUS telecommunications loan and security instrument provisions. The rule clarifies that section to require the CPA to determine whether the borrower is in compliance with the provisions pertaining to the funded reserve requirements and net plant to secured debt ratio requirements for RUS loans approved after June 10, 1991, and before October 7, 1997, and the funded reserve requirement for RTB loans approved after June 10, 1991.

Both the management letters for electric and telecommunications borrowers were modified to remove the negative assurance language pertaining to items not tested in conformance with GAGAS.

The January 3, 1996, interim final rule also amended Sections 1773.5, Qualifications of CPA, and 1773.6, Audit Agreement, to include changes

necessitated by the 1994 revision of GAGAS. In that amendment, the abbreviation OIG (Office of Inspector General, United States Department of Agriculture) was inadvertently replaced by OGC (Office of General Counsel) in paragraph 1773.5(c)(6)(iii) and paragraph 1773.6(a)(6). This final rule corrects that error.

The renaming of the Borrower Accounting Division (BAD) to the Program Accounting Services Division (PASD) was not incorporated into the interim final rule. This final rule serves to incorporate the name change by deleting all references to BAD and replacing them with PASD.

This final rule also adds a definition of the term "borrower" to mean all entities which receive financial assistance in the form of loans, loan guarantees, or grants from RUS.

Comments

An interim final rule entitled "Policy on Audits of RUS Borrowers," published January 3, 1996, at 61 FR 104, invited interested parties to submit comments on or before March 4, 1996. Comments were received from three accounting firms, the Assistant Administrator, Telecommunications Program, the Deputy Assistant Administrator, Electric Program, and from OIG. The following paragraphs address the topics that were discussed by the two commenters.

Comment. The revisions to §§ 1773.33(e)(1)(iii) and 1773.33(e)(2)(iii) require the CPA to state whether the information submitted by a borrower to RUS in its most recent December 31 RUS Form 7, Financial and Statistical Report; Form 12, Operating Report—Financial; or Form 479, Financial and Statistical Report for Telephone Borrowers, is in agreement with the borrower's "audited" records. Commenters expressed concern that this requirement did not properly consider borrowers with fiscal year ends other than December 31. One commenter asked if this requirement necessitated a calendar year audit or alternate audit procedures to comply.

Response. The intent of this section was to require CPAs to state whether the information submitted by a borrower to RUS in its most recent December 31 RUS Form 7, 12, or 479 was in agreement with the borrower's audited records if the borrower has a December 31 year end. For borrowers with year ends other than December 31, the section was intended to require the CPA to state whether the information provided appeared reasonable based upon the procedures performed during

the audit. The final rule has been amended to clarify this requirement.

Comment. When 7 CFR part 1717 was revised by the electric program, certain modifications affected part 1773. In § 1717.608, RUS approval of contracts between the borrower and its manager are no longer required. Additionally, the electric program determined that the quantification of "substantial part" was too low and raised it to 90 percent. Section 1717.612 defined funds as cash proceeds from loans made or guaranteed by RUS. These changes should be incorporated into part 1773.

Response. This final rule has been amended to incorporate the changes necessitated by revisions made to part 1717.

Comment. The revisions to § 1773.33(e)(2) excluded a requirement for compliance with RUS loan and security instrument provision for telecommunications borrowers. Under existing regulations, if the loan maturity period selected by the borrower exceeds the expected composite economic life of the facilities financed by a period of more than three years, the loan is conditioned upon the borrower electing to maintain a net plant to secured debt ratio of at least 1.2, or a funded reserve in such amount that the balance of the reserve plus the value of the facilities less depreciation be at least equal to the remaining principal payments on the loan.

Response. It was not our intent to omit this requirement for compliance with the RUS loan and security instrument from the management letter. The final rule has been amended to include this requirement.

Comment. One commenter noted that the management letter in part 1773 included a sentence that was in conflict with GAGAS. It was his opinion that the sentence concerning negative assurance should be eliminated from the management letter.

Response. We agree with the comment and we have deleted this sentence from the management letter.

Comment. The revision to § 1773.5(c)(4)(C) set forth in the January 3, 1996, interim final rule extended the timeframe for submission of peer reviews to 42 months. Commenters expressed concern that the 42 months timeframe did not meet the requirements of GAGAS.

Response. The intent of this section was to provide a 6-month period for CPAs to submit their peer review reports to RUS. Upon further review of the interim final rule, we have revised the language in the final rule to require completion of peer reviews within 36

months of the issuance of the prior review in accordance with GAGAS.

List of Subjects in 7 CFR Part 1773

Accounting, Electric power, Loan programs—communications, Loan programs—energy, Reporting and recordkeeping requirements, Rural areas, Telecommunications.

For reasons set forth in the preamble, RUS hereby amends 7 CFR part 1773 chapter XVII as follows:

Authority: 7 U.S.C. 901 et seq.; 7 U.S.C. 1921 et seq.; Pub. L. 103-354, 108 Stat. 3178 (7 U.S.C. 6941 et seq.).

PART 1773—POLICY ON AUDITS OF RUS BORROWERS

1. The authority citation for part 1773 continues to read as follows:

2. In part 1773 all references to items indicated in the left column are revised to read as stated in the right column:

Table with 2 columns: Remove BAD—Borrower Accounting Division, Add PASD—Program Accounting Services Division. Rows include Director, BAD, Telephone Program report on compliance, Report on internal controls, and Report on compliance and internal controls.

3. Section 1773.2 is amended by adding the definition for Borrower.

§ 1773.2 Definitions.

* * * * *

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

* * * * *

4. Section 1773.3 is amended by removing paragraph (d)(2), redesignating paragraphs (d)(3) and (d)(4) to (d)(2) and (d)(3) and revising paragraphs (d) introductory text, (d)(1) through (d)(3) introductory text, (d)(3)(ii) and (e).

§ 1773.3 Annual audit.

* * * * *

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

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

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

(3) A borrower must notify RUS, in writing, within 30 days of the as of audit

date, of the total Federal awards expended during the year and must state whether it will have an audit performed in accordance with the Single Audit Act of 1984 and the Single Audit Act Amendments of 1996, or this part.

* * * * *

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

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

* * * * *

5. Section 1773.5 is amended by revising paragraphs (c) introductory text and (c)(6) (iii) to read as follows:

§ 1773.5 Qualifications of CPA.

* * * * *

(c) Peer review requirement. The CPA must belong to and participate in a peer review program, and must have undergone a satisfactory peer review of the accounting and audit practice conducted by an approved peer review program under paragraph (c)(4) of this section, unless a waiver is granted under paragraph (c)(7) of this section. The reviewing organization must not be affiliated with or have had its most recent peer review conducted by the organization currently being reviewed (reciprocal reviews). After the initial peer review has been performed, the CPA must undergo a peer review of the accounting and audit practice within 36 months of the issuance of the previous

peer review or at such additional times as designated by the peer review executive committee.

* * * * *

(6) * * *

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

* * * * *

6. Section 1773.6 is amended by revising paragraph (a)(6) to read as follows:

§ 1773.6 Audit agreement.

(a) * * *

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

* * * * *

7. Section 1773.30 is amended by removing paragraph (a)(3), and redesignating paragraph (a)(4) to (a)(3) and revising paragraphs (a)(2) and (a)(3) to read as follows:

§ 1773.30 General.

(a) * * *

(2) A report on compliance and on internal control over financial reporting, examples of which are set forth in appendices A, exhibits 2 and 3 (Electric) and B, exhibits 4 and 5 (Telecommunications) of this part 1773; and

(3) A management letter, an example of which is set forth in appendix C of this part 1773.

* * * * *

8a. Section 1773.31 is amended by revising the last sentence to read as follows:

§ 1773.31 Auditor's Report.

* * * This report must be signed by the CPA, cover all statements presented, and refer to the separate report on compliance and on internal control over financial reporting issued in conjunction with the auditor's report.

8b. Section 1773.32 is revised to read as follows:

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

As required by GAGAS, the CPA must prepare a written report on the tests performed for compliance with applicable laws, regulations, contracts, and grants, and on the borrower's internal control structure and on the assessment of control risk made as part of the financial statement audit. This report must be signed by the CPA and must include, as a minimum:

(a) The scope of the CPA's work to obtain an understanding of the borrower's internal control structure and in assessing the control risk;

(b) A description of the reportable conditions noted which include material weaknesses identified as a result of the CPA's work in understanding and assessing control risk;

(c) If no reportable instances of noncompliance and no reportable conditions were found, the CPA must issue a report as illustrated in appendix A, exhibit 2 (Electric), and appendix B, exhibit 4 (Telecommunications) of this part 1773;

(d) If material instances of noncompliance and reportable conditions are identified, the CPA must issue a report as illustrated in appendix A, exhibit 3 (Electric), and appendix B, exhibit 5 (Telecommunications) of this part 1773;

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

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

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

(g) If the CPA has issued a separate letter to management to communicate

other matters involving the design and operation of the internal control over financial reporting, the report on compliance and on internal control over financial reporting must be modified to include a statement such as:

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

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

9. Section 1773.33 is removed.

10. Section 1773.34 is redesignated to § 1773.33 and amended by removing paragraph (e)(1)(ii)(E), revising paragraphs (e)(1)(i), (e)(1)(ii) introductory text, (e)(1)(ii)(C) and (e)(1)(iii) and (e)(2)(iii) and adding (e)(2)(iv) to read as follows:

§ 1773.33 Management letter.

* * * * *

(e) * * *

(1) * * *

(i) The requirement for funds to be deposited in banks or other depositories designated in the loan documents or approved by RUS. For purposes of this part, funds shall be defined as cash proceeds from loans made or guaranteed by RUS in accordance with 7 CFR 1717.612.

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

* * * * *

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

* * * * *

(iii) The requirement for a borrower to prepare and furnish mortgagees annual financial and statistical reports on the borrower's financial condition and operations. For borrowers with a December 31 year end, the CPA must state whether the information represented by the borrower as having been submitted to RUS in its most recent December 31 RUS Form 7 or Form 12 is in agreement with the borrower's audited records. For borrowers with a year end other than

December 31, the CPA must state whether the information appears reasonable based upon the audit procedures performed. If the borrower represents that an amended report has been filed as of December 31, the comments must relate to the amended report.

(2) * * *

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

(iv) The requirement that a borrower maintain either a net plant to secured debt ratio or a funded reserve.

(A) For loans approved after June 10, 1991, and before October 7, 1997, if a borrower selected a loan maturity period in excess of the expected economic life of the facilities financed, the borrower must maintain a secured debt ratio of at least 1.2 or a funded reserve. If, during the audit period, the borrower has been issued refunding notes that match the remaining composite economic life of the facilities thus eliminating the requirement, the auditor should so state.

(1) If the net plant to secured debt ratio option was selected, this ratio must be achieved one year following the first advance of funds.

(2) If the funded reserve option was selected, the reserve must be of such amount that the balance of the reserve plus the value of the facilities less depreciation be at least equal to the remaining principal payments on the loan. Funding of the reserve must begin within one year of approval of release of funds and must continue regularly over the composite economic life of the facilities financed.

(B) For loans approved after October 7, 1997, if a borrower selected a loan maturity period in excess of the expected economic life of the facilities financed, the borrower must maintain a funded reserve in such amount that the balance of the reserve plus the value of the facilities less depreciation be at least equal to the remaining principal

payments on the loan. Funding of the reserve must begin within one year of approval of release of funds and must continue regularly over the composite economic life of the facilities financed. If, during the audit period, the borrower has been issued refunding notes that match the remaining composite economic life of the facilities thus eliminating the requirement for maintaining the funded reserve requirement, the auditor should so state.

* * * * *

11. Reserve § 1773.34.

12. Appendix A to Part 1773 is amended by revising exhibits 1, 2, and 3, removing exhibits 4, 5, and 6, and redesignating exhibit 7 as exhibit 4 and revising it to read as follows:

Appendix A to Part 1773—Sample Auditor's Report for an Electric Cooperative

* * * * *

Exhibit 1—Sample Auditor's Report

Certified Public Accountants, 1600 Main Street, City, State 24105
The Board of Directors, Center County Electric Cooperative: Independent Auditor's Report

We have audited the accompanying balance sheets of Center County Electric Cooperative as of December 31, 1998 and 1997, and the related statements of revenue and patronage capital, and cash flows for the years then ended. These financial statements are the responsibility of Center County Electric Cooperative's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Center County Electric Cooperative as of December 31, 1998 and 1997, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

In accordance with Government Auditing Standards, we have also issued a report dated March 2, 1999, on our consideration of Center County Electric Cooperative's internal control over financial reporting and our tests

of its compliance with certain provisions of laws, regulations, contracts, and grants.

Certified Public Accountants

March 2, 1999

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

Certified Public Accountants, 1600 Main Street, City, State 24105

The Board of Directors

Center County Electric Cooperative:

We have audited the financial statements of Center County Electric Cooperative as of and for the years ended December 31, 1998 and 1997, and have issued our report thereon dated March 2, 1999. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether Center County Electric Cooperative's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards. [If the CPA has issued a separate letter to the management detailing immaterial instances of noncompliance, modify this paragraph to include a statement such as the following: However, we noted certain immaterial instances of noncompliance which we have reported to the management of Center County Electric Cooperative in a separate letter dated March 2, 1999.]

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Center County Electric Cooperative's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of

performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. [If the CPA has issued a separate letter to management to communicate other matters involving the design and operation of the internal control over financial reporting, modify this paragraph to include a statement such as the following: However, we noted other matters involving the internal control over financial reporting which we have reported to the management of Center County Electric Cooperative in a separate letter dated March 2, 1999.]

This report is intended for the information of the audit committee, management, the Rural Utilities Service, and supplemental lenders. However, this report is a matter of public record and its distribution is not limited.

Certified Public Accountants

March 2, 1999

Exhibit 3—Sample Report on Compliance and on Internal Control over Financial Reporting, the CPA found Reportable Instances of noncompliance and Reportable Conditions Identified.

Certified Public Accountants, 1600 Main Street, City, State 24105

The Board of Directors

Center County Electric Cooperative:

We have audited the financial statements of Center County Electric Cooperative as of and for the years ended December 31, 1998 and 1997, and have issued our report thereon dated March 2, 1999. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether Center County Electric Cooperative's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance that are required to be reported under Government Auditing Standards. [A description of the findings should be included in the report.] [If the CPA has issued a separate letter to the management detailing immaterial instances of noncompliance, modify this paragraph to include a statement such as the following: We also noted certain immaterial instances of noncompliance which we have reported to the management of Center County Electric Cooperative in a separate letter dated March 2, 1999.]

Internal Control Over Financial Reporting

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

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe none of the reportable conditions described above is a material weakness. [If conditions believed to be material weaknesses are disclosed, the last sentence should be deleted and instead the report should identify which of the

reportable conditions described above are considered to be material weaknesses.] [If the CPA has issued a separate letter to management to communicate other matters involving the design and operation of the internal control over financial reporting, modify this paragraph to include a statement such as the following: We also noted other matters involving the internal control over financial reporting which we have reported to the management of Center County Electric Cooperative in a separate letter dated March 2, 1999.]

This report is intended for the information of the audit committee, management, the Rural Utilities Service, and supplemental lenders. However, this report is a matter of public record and its distribution is not limited.

Certified Public Accountants

March 2, 1999

EXHIBIT 4—SAMPLE FINANCIAL STATEMENTS**CENTER TELEPHONE COMPANY BALANCE SHEETS—DECEMBER 31, 19X9 AND 19X8 ASSETS (NOTES 1 AND 2)**

	19X9	19X8
CURRENT ASSETS:		
Cash—Construction Funds	\$21,000	\$18,000
Cash—General Funds	128,300	140,083
Telecommunications Accounts		
Receivable (less accumulated provision of \$11,597 in 19X9 and \$1,490 in 19X8)	139,642	122,623
Notes Receivable	2,500	3,000
Materials and Supplies	103,713	73,964
Prepayments (Note 3)	49,185	62,201
Other Current Assets	1,357	10,131
	445,697	430,002
NONCURRENT ASSETS:		
Nonregulated Investments: (Note 4)		
Net CATV Plant	413,511	407,086
Net Nonregulated Customer Premises Equipment	103,618	0
Deferred Maintenance and Retirements (Note 5)	40,000	45,000
	557,129	452,086
PROPERTY, PLANT, AND EQUIPMENT: (Note 6)		
Telecommunications Plant in Service	7,401,300	6,650,553
Telecommunications Plant Under Construction	67,626	199,092
Telecommunications Plant Adjustment (Note 7)	176,380	176,380
	7,645,306	7,026,025
Less: Accumulated Provision for Depreciation	1,760,587	1,504,255
	5,884,719	5,521,770
	6,887,545	6,403,858

The accompanying notes are an integral part of these statements.

CENTER TELEPHONE COMPANY BALANCE SHEETS—DECEMBER 31, 19X9 AND 19X8 LIABILITIES AND EQUITIES

	19X9	19X8
CURRENT LIABILITIES:		
Accounts Payable	\$123,689	\$290,484
Notes Payable	61,600	70,400
Advance Billings and Payments	2,137	2,243
Customers Deposits	11,878	4,940
Current Maturities of Long-Term Debt (Note 8)	146,646	145,998
Accrued Taxes	242,076	224,566

CENTER TELEPHONE COMPANY BALANCE SHEETS—DECEMBER 31, 19X9 AND 19X8 LIABILITIES AND EQUITIES—
Continued

	19X9	19X8
Other Current Liabilities	8,500	9,079
	596,526	747,710
LONG-TERM DEBT:		
RUS Mortgage Notes (Note 8)	4,592,658	4,128,106
OTHER LIABILITIES AND DEFERRED CREDITS:		
Unamortized Investment Tax Credits (Note 10)	53,078	61,377
Deferred Income Taxes (Note 11)	37,137	35,039
	90,215	96,416
STOCKHOLDERS' EQUITY:		
Capital Stock—Common \$2 par value—300,000 Shares Authorized; 102,600 Shares Outstanding 19X9 and 19X8	205,200	205,200
Additional Paid-in Capital	820,800	820,800
Retained Earnings (Note 8)	582,146	405,626
	1,608,146	1,431,626
	6,887,545	6,403,858

The accompanying notes are an integral part of these statements.

CENTER TELEPHONE COMPANY STATEMENTS OF INCOME AND RETAINED EARNINGS FOR THE YEARS ENDED DECEMBER
31, 19X9 AND 19X8

	19X9	19X8
OPERATING REVENUES:		
Basic Local Network Services	\$836,822	\$862,205
Network Access Services	125,042	-0-
Long Distance Network Services	897,300	775,073
Miscellaneous	144,435	147,100
Less: Uncollectible Revenues	(24,000)	(24,500)
	1,979,599	1,759,878
OPERATING EXPENSES:		
Plant Specific Operations	564,486	480,509
Plant Nonspecific Operations	187,162	393,143
Depreciation and Amortization	274,691	274,691
Customer Operations	94,473	78,772
Corporate Operations	157,453	134,127
	1,278,265	1,086,551
OPERATING TAXES:		
Federal and State Income Taxes—Operating (Notes 10 and 11)	159,845	170,687
Other Operating Taxes	225,013	204,230
Provision for Deferred Taxes (Note 10)	31,566	29,468
Investment Credits—Net	6,201	1,640
	422,625	406,025
OPERATING INCOME	278,709	267,302
FIXED CHARGES:		
Interest on Long-Term Debt	88,432	85,854
Interest Charged to Construction Credit	(2,251)	(1,516)
	86,181	84,338
NONREGULATED INCOME—NET (Note 4)	19,902	10,593
NET INCOME FOR PERIOD	212,430	193,557
Retained Earnings—January 1, 19X9 and 19X8	405,626	235,153
Dividends Declared	(35,910)	(23,084)

CENTER TELEPHONE COMPANY STATEMENTS OF INCOME AND RETAINED EARNINGS FOR THE YEARS ENDED DECEMBER
31, 19X9 AND 19X8—Continued

	19X9	19X8
Retained Earnings—December 31, 19X9 and 19X8	\$582,146	\$405,626
Earnings Per Share of Common Stock—Average	\$2.07	\$1.89

The accompanying notes are an integral part of these statements.

CENTER COUNTY TELEPHONE COMPANY STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 19X9
AND 19X8

	19X9	19X8
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash Received from Consumers	\$1,962,580	\$1,733,289
Cash Paid to Suppliers and Employees	(1,159,158)	(960,459)
Interest Paid	(86,181)	(84,338)
Taxes Paid	(401,316)	(376,643)
Net Cash Provided by Operating Activities	315,925	311,849
CASH FLOWS FROM INVESTING ACTIVITIES:		
Construction and Acquisition of Plant	(619,281)	(507,617)
Investment in CATV Plant	(6,425)	(18,246)
Investment in Nonregulated CPE	(103,618)	
Plant Removal Costs	(18,359)	(27,216)
(Increase)/Decrease In:		
Materials Inventory	(29,749)	(19,478)
Notes Receivable	500	1,000
Deferred Maintenance and Retirements	5,000	(45,000)
Nonregulated Income	19,902	10,593
Net Cash Used in Investing Activities	(752,030)	(605,964)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Dividends Paid	(35,910)	(23,084)
Debt Proceeds	465,200	386,000
Payments on Short-term Debt	(8,800)	(7,500)
Increase/(Decrease) In:		
Consumer Deposits and Advance Payments	6,832	4,200
Net Cash Provided by Financing Activities	427,322	359,616
Net Increase/(Decrease) in Cash	(8,783)	65,501
Cash—Beginning of Year	158,083	92,582
Cash—End of Year	149,300	158,083
The accompanying notes are an integral part of these statements.		
RECONCILIATION OF NET MARGINS TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Net Margins	212,430	193,557
Less: Nonregulated Income	(19,902)	(10,593)
Net Income from Regulated Operations	192,528	182,964
Adjustments to Reconcile Net Margins to Net Cash Provided by Operating Activities:		
Depreciation and Amortization	274,691	253,509
Provision for Uncollectible Accounts Receivable	10,107	(3,610)
(Increase)/Decrease In:		
Customer and Other Accounts Receivable	(27,126)	(22,979)
Current and Accrued Assets—Other	8,774	5,119
Prepaid Taxes	10,000	(10,000)
Other Prepaid Expenses	3,016	(5,426)
Increase/(Decrease) In:		
Accounts Payable	(166,795)	(126,472)
Accrued Taxes	17,510	37,742
Other Current Liabilities	(579)	(638)
Deferred Credits	(6,201)	1,640
Total Adjustments	123,397	128,885
Net Cash Provided by Operating Activities	315,925	311,849

The accompanying notes are an integral part of these statements.

13. Appendix B to Part 1773 is amended by revising exhibits 1, 2, and 3, deleting exhibits 4, 5 and 6, and redesignating exhibit 7 as exhibit 4 and revising it to read as follows:

Appendix B to Part 1773—Sample Auditor's Report for A Class A or B Commercial Telecommunications Company

* * * * *

Exhibit 1—Same Auditor's Report

Certified Public Accountants, 1600 Main Street, City, State 24105
The Board of Directors, Center Telephone Company: Independent Auditor's Report

We have audited the accompanying balance sheets of Center Telephone Company as of December 31, 1998 and 1997, and the related statements of revenue and patronage capital, and cash flows for the years then ended. These financial statements are the responsibility of Center Telephone Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Center Telephone Company as of December 31, 1998 and 1997, and the results of its operations and its cash flows for the years then ended in conformity with general accepted accounting principles.

In accordance with Government Auditing Standards, we have also issued our report dated March 2, 1999, on our consideration of Center Telephone Company's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants.

Certified Public Accountants

March 2, 1999

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

Certified Public Accountants, 1600 Main Street, City, State 24105

The Board of Directors

Center Telephone Company:

We have audited the financial statements of Center Telephone Company as of and for the years ended December 31, 1998 and 1997, and have issued our report thereon dated March 2, 1999. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether Center Telephone Company's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards. [If the CPA has issued a separate letter to the management detailing immaterial instances of noncompliance, modify this paragraph to include a statement such as the following: However, we noted certain immaterial instances of noncompliance which we have reported to the management of Center Telephone Company in a separate letter dated March 2, 1999.]

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Center Telephone Company's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. [If the CPA has issued a separate letter to management to communicate other matters involving the design and operation of the internal control over financial reporting, modify this paragraph to include a statement such as the following: However, we noted other matters involving the internal control over financial reporting which we have reported to the management of Center

Telephone Company in a separate letter dated March 2, 1999.]

This report is intended for the information of the audit committee, management, the Rural Utilities Service, and supplemental lenders. However, this report is a matter of public record and its distribution is not limited.

Certified Public Accountants

March 2, 1999

Exhibit 3—Sample Report on Compliance and on Internal Control over Financial Reporting, the CPA found Reportable Instances of Noncompliance and Reportable Conditions were Identified

Certified Public Accountants, 1600 Main Street, City, State 24105

The Board of Directors

Center Telephone Company

We have audited the financial statements of Center Telephone Company as of and for the years ended December 31, 1998 and 1997, and have issued our report thereon dated March 2, 1999. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether Center Telephone Company's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards*. [A description of the findings should be included in the report.] [If the CPA has issued a separate letter to the management detailing immaterial instances of noncompliance, modify this paragraph to include a statement such as the following: We also noted certain immaterial instances of noncompliance which we have reported to the management of Center Telephone Company in a separate letter dated March 2, 1999.]

Internal Control Over Financial Reporting

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

internal control over financial reporting that, in our judgment, could adversely affect Center Telephone Company's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. [A description of the findings pertaining to reportable conditions should be included in the report.]

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of

performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe none of the reportable conditions described above is a material weakness. [If conditions believed to be material weaknesses are disclosed, the last sentence should be deleted and instead the report should identify which of the reportable conditions described above are considered to be material weaknesses.] [If the CPA has issued a separate letter to management to communicate other matters

involving the design and operation of the internal control over financial reporting, modify this paragraph to include a statement such as the following: We also noted other matters involving the internal control over financial reporting which we have reported to the management of Center Telephone Company in a separate letter dated March 2, 1999.]

This report is intended for the information of the audit committee, management, the Rural Utilities Service, and supplemental lenders. However, this report is a matter of public record and its distribution is not limited.

Certified Public Accountants
March 2, 1999

EXHIBIT 4—SAMPLE FINANCIAL STATEMENTS

CENTER COUNTY ELECTRIC COOPERATIVE BALANCE SHEETS—DECEMBER 31, 19X9 AND 19X8 ASSETS (NOTES 1 AND 2)

	19X9	19X8
ELECTRIC PLANT: (Note 3)		
In Service—at cost	\$9,524,646	\$9,365,264
Construction Work in Progress	407,943	317,166
	9,932,589	9,682,430
Less: Accumulated Provisions for Depreciation	3,117,629	2,917,295
	6,814,960	6,765,135
OTHER ASSETS AND INVESTMENTS:		
Nonutility Property	20,227	20,227
Investments in Associated Organizations (Note 4)	391,258	292,798
	411,485	313,025
CURRENT ASSETS:		
Cash—General Funds	37,350	51,544
Cash—Construction Funds	10,034	20,193
Accounts Receivable (Less accumulated provision for uncollectible accounts of \$2,207 in 19X9 and \$1,933 in 19X8)	36,527	35,255
Materials and Supplies (at average cost)	83,652	80,882
Other Current and Accrued Assets	8,613	8,692
	176,176	196,566
DEFERRED CHARGES (Note 5):	5,666	1,762
	\$7,408,287	\$7,276,488

The accompanying notes are an integral part of these statements.

CENTER COUNTY ELECTRIC COOPERATIVE BALANCE SHEETS—DECEMBER 31, 19X9 AND 19X8 EQUITIES AND LIABILITIES (NOTE 1)

	19X9	19X8
EQUITIES:		
Memberships	\$60,145	\$59,440
Patronage Capital (Note 6)	1,761,798	1,526,833
Other Equities (Note 7)	53,647	35,900
	1,875,590	1,622,173
LONG-TERM DEBT:		
RUS Mortgage Notes less current maturities (Note 8)	5,249,115	5,396,385
CURRENT LIABILITIES:		
Current Maturities of Long-Term Debt	145,000	140,000
Accounts Payable—Purchased Power	48,916	52,117
Accounts Payable—Other	21,859	6,556
Consumer Deposits	32,660	33,085

CENTER COUNTY ELECTRIC COOPERATIVE BALANCE SHEETS—DECEMBER 31, 19X9 AND 19X8 EQUITIES AND LIABILITIES
(NOTE 1)—Continued

	19X9	19X8
Accrued Taxes	10,958	9,146
Other Current and Accrued Liabilities	12,285	6,461
	271,678	247,365
DEFERRED CREDITS (Note 10)	11,904	10,565
	\$7,408,287	\$7,276,488

The accompanying notes are an integral part of these statements.

CENTER COUNTY ELECTRIC COOPERATIVE STATEMENTS OF REVENUE AND PATRONAGE CAPITAL FOR THE YEARS ENDED
DECEMBER 31, 19X9 AND 19X8

	19X9	19X8
OPERATING REVENUES	\$1,719,467	\$1,605,690
OPERATING EXPENSES:		
Cost of Power	587,729	625,411
Distribution—Operation	111,058	121,682
Distribution—Maintenance	158,622	182,740
Consumer Accounts	76,675	72,927
Sales	38,378	40,755
Administrative and General	94,682	87,058
Depreciation and Amortization	288,389	279,776
Taxes	34,920	34,438
	1,390,453	1,444,787
OPERATING MARGINS BEFORE FIXED CHARGES	329,014	160,903
FIXED CHARGES:		
Interest on Long-Term Debt	113,713	115,082
OPERATING MARGINS AFTER FIXED CHARGES	215,301	45,821
G&T AND OTHER CAPITAL CREDITS	14,460	17,500
NET OPERATING MARGINS	229,761	63,321
NONOPERATING MARGINS:		
Interest Income	24,289	18,802
Other Nonoperating Income	1,200	1,200
	25,489	20,002
NET MARGINS	255,250	83,323
PATRONAGE CAPITAL—BEGINNING OF YEAR	1,526,833	1,469,125
	1,782,083	1,552,448
RETIREMENT OF CAPITAL CREDITS	20,285	25,615
PATRONAGE CAPITAL—END OF YEAR	\$1,761,798	\$1,526,833

The accompanying notes are an integral part of these statements.

CENTER COUNTY ELECTRIC COOPERATIVE STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 19X9
AND 19X8

	19x9	19x8
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash Received from Consumers	\$1,721,496	\$1,609,933
Cash Paid to Suppliers and Employees	(1,049,139)	(1,126,367)
Interest Received	24,289	18,802
Interest Paid	(114,131)	(115,607)
Taxes Paid	(33,108)	(32,132)
Net Cash Provided by Operating Activities	549,407	354,629
CASH FLOWS FROM INVESTING ACTIVITIES:		
Construction and Acquisition of Plant	(322,234)	(216,427)

CENTER COUNTY ELECTRIC COOPERATIVE STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 19X9
AND 19X8—Continued

	19x9	19x8
Plant Removal Costs	(25,994)	(19,268)
Materials Salvaged from Retirements	10,014	7,327
(Increase)/Decrease In:		
Materials Inventory	(2,770)	1,916
Deferred Charges-Preliminary Survey & Investigation	(3,486)	(2,617)
Investments-CFC Capital Term Certificates	(82,472)	(69,412)
Inventory Adjustment-Deferred Credit Decrease	(2,290)	(1,057)
Net Cash Used in Investing Activities	(429,232)	(299,538)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Retirements of Patronage Capital Credits	(20,285)	(25,615)
Retired Capital Credits—Gain	1,200	1,200
Donated Capital	16,547	6,178
RUS Loan Advances	174,976	197,450
Payments on RUS Debt	(317,246)	(279,575)
Increase/(Decrease) In:		
Consumer Deposits	(425)	575
Memberships Issued	705	450
Net Cash Used in Financing Activities	(144,528)	(99,337)
Net Increase/(Decrease) in Cash	(24,353)	(44,246)
Cash—Beginning of Year	71,737	115,983
Cash—End of Year	47,384	71,737
The accompanying notes are an integral part of these statements.		
RECONCILIATION OF NET MARGINS TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Net Margins	\$255,250	\$83,323
Adjustments to Reconcile Net Margins to Net Cash Provided by Operating Activities:		
Depreciation and Amortization	288,389	279,776
G&T and Other Capital Credits (Non-Cash)	(14,460)	(17,500)
Patronage Capital Credits-NRUCFC (Non-Cash)	(1,528)	(1,200)
Provision for Uncollectible Accounts Receivable	274	(526)
(Increase)/Decrease In:		
Customer and Other Accounts Receivable	(1,546)	2,523
Current and Accrued Assets-Other	79	112
Increase/(Decrease) In:		
Accounts Payable	12,102	5,117
Accrued Taxes	1,812	2,306
Deferred Energy Prepayments	3,629	2,246
Current and Accrued Liabilities-Other	5,824	(1,023)
Deferred Interest Expense	(418)	(525)
Total Adjustments	294,157	271,306
Net Cash Provided by Operating Activities	549,407	354,629

The accompanying notes are an integral part of these statements.

CENTER COUNTY ELECTRIC COOPERATIVE NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 19X9 AND DECEMBER 31,
19X8

	19X9	19X8
1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:		
Include a brief description of the reporting entity's significant accounting policies in accordance with Accounting Principles Board Opinion No. 22, Disclosure of Accounting Policies.		
Disclosure of accounting policies should identify and describe the accounting principles followed by the borrower and the methods of applying those principles that materially affect the determination of financial position, cash flow, and results of operations.		
Disclosures of accounting policies do not have to be duplicated in this section if presented elsewhere as an integral part of the financial statements.		
2. ASSETS PLEDGED:		
Substantially all assets are pledged as security for long-term debt to RUS.		
3. ELECTRIC PLANT AND DEPRECIATION RATES AND PROCEDURES:		
Listed below are the major classes of the electric plant as of December 31, 19X9, and 19X8:		
Intangible Plant	\$2,194	\$2,194
Distribution Plant	9,011,036	8,873,957
General Plant	511,416	489,113
Electric Plant in Service	9,524,646	9,365,264

CENTER COUNTY ELECTRIC COOPERATIVE NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 19X9 AND DECEMBER 31,
19X8—Continued

	19X9	19X8
Construction Work in Progress	407,943 9,932,589	317,166 9,682,430
Provision has been made for depreciation of distribution plant at a straight-line composite rate of 2.86 percent per annum. General Plant depreciation rates have been applied on a straight-line basis as follows:		
Structures and Improvement	2.5%	
Office Furniture	6.0%	
Transportation Equipment	14.0%	
Power Operated Equipment	12.0%	
Other General Plant	4.0%	
Communications Equipment	6.0%	
4. INVESTMENTS IN ASSOCIATED ORGANIZATIONS:		
Investments in associated organizations consisted of the following at December 31, 19X9 and 19X8:		
Capital Term Certificates of the National Rural Utilities Cooperative Finance Corporation (NRUCFC)	\$385,193	\$288,261
NRUCFC Patronage Capital Credits	5,065	3,537
Other	1,000	1,000
	391,258	292,798
5. DEFERRED CHARGES:		
Following is a summary of amounts recorded as deferred charges as of December 31, 19X9 and 19X8:		
Preliminary Surveys 19X0—X1 Work Plan	5,666	1,762
6. PATRONAGE CAPITAL:		
At December 31, 19X9 and 19X8, patronage capital consisted of:		
Assignable	\$255,250	\$83,323
Assigned to Date	1,952,448	1,869,125
	2,207,698	1,952,448
Less: Retirements to Date	445,900	425,615
	1,761,798	1,526,833
Under the provisions of the Mortgage Agreement, until the equities and margins equal or exceed forty percent of the total assets of the cooperative, the return to patrons of contributed capital is generally limited to twenty-five percent of the patronage capital or margins received by the cooperative in the prior calendar year. The equities and margins of the cooperative represent 25.3 percent of the total assets at balance sheet date. Capital credit retirements in the amount of \$20,285 were paid in 19X9.		
7. OTHER EQUITIES:		
At December 31, 19X9 and 19X8, other equities consisted of:		
Retired Capital Credits—Gain	\$36,190	\$34,990
Donated Capital	17,457	910
	53,647	35,900
8. MORTGAGE NOTES—RUS:		
Long-term debt is represented by mortgage notes payable to the United States of America. Following is a summary of outstanding long-term debt as of December 31, 19X9 and 19X8:		
2% Notes due March 31, 19X5	\$1,057,155	\$1,098,700
2% Notes due December 31, 19X6	2,485,927	2,502,370
5% Notes due December 31, 19X6	1,851,033	1,935,315
Less: Current Maturities	(145,000)	(140,000)
	5,249,115	5,396,385
Unadvanced loan funds of \$285,600 are available to the cooperative on loan commitments from RUS. Principal and interest installments on the above notes are due quarterly in equal amounts of \$99,600. As of December 31, 19X9, annual maturities of long-term debt outstanding for the next five years are as follows:		
19X0	\$145,000	
19X1	150,000	
19X2	151,500	
19X3	154,000	
19X4	155,000	
Advance payments of \$252,300 may be applied to the installments.		
9. PENSION PLAN:		
Substantially all of the employees of the Cooperative are covered by the ABC Retirement and Security Program, a multiemployer plan. Pension expense for the years ended 19X9 and 19X8 was \$22,400.00 and \$20,400.00, respectively.		
10. DEFERRED CREDITS:		
Following is a summary of the amounts recorded as deferred credits as of December 31, 19X9 and 19X8:		
Customer Energy Payments	\$6,694	\$3,065
Inventory Adjustment	5,210	7,500

CENTER COUNTY ELECTRIC COOPERATIVE NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 19X9 AND DECEMBER 31, 19X8—Continued

	19X9	19X8
	11,904	10,565

11. LITIGATION:

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

12. COMMITMENTS:

Under its wholesale power agreement, the cooperative is committed to purchase its electric power and energy requirements from Central Power Cooperative, Inc., until December 31, 19XX. The rates paid for such purchases are subject to review annually.

14. Appendix C To Part 1773 is revised to read as follows:

Appendix C to Part 1773—Illustrative Independent Auditor’s Management Letter for Electric Borrowers

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

Illustrative Independent Auditors’ Management Letter for Electric Borrowers

March 2, 1999

Board of Directors

[Name of Borrower]

[City, State]

We have audited the financial statements of [Name of Borrower] for the year ended December 31, 1998, and have issued our report thereon dated March 2, 1999. We conducted our audit in accordance with generally accepted auditing standards, the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States, and 7 CFR part 1773, Policy on Audits of Rural Utilities Service (RUS) Borrowers. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

In planning and performing our audit of the financial statements of [Name of Borrower] for the year ended December 31, 1998, we considered its internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the internal control over financial reporting.

A description of the responsibility of management for establishing and maintaining the internal control over financial reporting and the objectives of and inherent limitations in such control is set forth in our independent auditors’ report on compliance and on internal control over financial reporting dated March 2, 1999, and should be read in conjunction with this report.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that

might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting that we consider to be material weaknesses. [If a material weakness was noted, refer the reader to the independent auditors’ report on compliance and on internal control over financial reporting structure.]

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

No reports (other than our independent auditors’ report and our independent auditors’ report on compliance and on internal control over financial reporting, all dated March 2, 1999) or summary of recommendations related to our audit have been furnished to management.

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

Comments on Certain Specific Aspects of the Internal Control Over Financial Reporting

We noted no matters regarding [Name of Borrower]’s internal control over financial reporting and its operation that we consider to be a material weakness as previously defined with respect to:

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

Comments on Compliance With Specific RUS Loan and Security Instrument Provisions

Management’s responsibility for compliance with laws, regulations, contracts, and grants is set forth in our independent auditors’ report on compliance and on internal control over financial reporting dated March 2, 1999, and should be read in conjunction with this report. At your request, we have performed the procedures enumerated below with respect to compliance with certain provisions of laws, regulations, contracts, and grants. The procedures we performed are summarized as follows:

- Procedure performed with respect to the requirement to maintain all funds from loans made or guaranteed by RUS in institutions whose accounts are insured by an Agency of the Federal government:
 1. Obtained information from financial institutions with which [Name of Borrower] maintains cash proceeds from loans that indicated that the institutions are insured by an Agency of the Federal government.
- Procedures performed with respect to the requirement for a borrower to obtain written approval of the mortgagee to enter into any contract for the operation or maintenance of property, or for the use of mortgaged property by others for the year ended December 31, 19X5 of [Name of Borrower]:

1. Obtained and read a borrower-prepared schedule of new written contracts entered into during the year for the operation or maintenance of its property, or for the use of its property by others as defined in § 1773.334 (e)(1)(ii).

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

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

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

1. Agreed amounts reported in Form 7 or Form 12 to [Name of Borrower]'s records.

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

—The borrower maintains all funds from loans made or guaranteed by RUS in institutions whose accounts are insured by an agency of the Federal government [list all exceptions];

—The borrower has obtained written approval of the RUS [and other mortgagees] to enter into any contract for the operation or maintenance of property, or for the use of mortgaged property by others as defined in § 1773.334 (e)(1)(ii) [list all exceptions]; and

—The borrower has submitted its Form 7 or Form 12 to the RUS and the Form 7 or Form 12, Financial and Statistical Report, as of December 31, 1998, represented by the borrower as having been submitted to RUS in agreement with the [Name of Borrower]'s audited records in all material respects [list all exceptions] [or if the audit year end is other than December 31], appears reasonable based upon the audit procedures performed [list all exceptions].

Comments on Other Additional Matters

In connection with our audit of the financial statements of [Name of Borrower], nothing came to our attention that caused us to believe that [Name of Borrower] failed to comply with respect to:

—The reconciliation of subsidiary plant records to the controlling general ledger plant accounts addressed at 7 CFR 1773.334 (c)(1) [list all exceptions];

—The clearing of the construction accounts and the accrual of depreciation on completed construction addressed at 7 CFR 1773.334 (c)(2) [list all exceptions];

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

—Sales of plant material, or scrap addressed at 7 CFR 1773.33 (c)(5) [list all exceptions];

—The disclosure of material related party transactions, in accordance with Statement of Financial Accounting Standards No. 57, Related Party Transactions, for the year ended December 31, 1998, in the financial statements referenced in the first paragraph of this report addressed at 7 CFR 1773.33 (f) [list all exceptions];

—The depreciation rates addressed at 7 CFR 1773.334 (g) [list all exceptions]; and

—The detailed schedule of deferred debits and deferred credits.

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

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

This report is intended solely for the information and use of the board of directors, management, and the RUS and supplemental lenders. However, this report is a matter of public record and its distribution is not limited.

Certified Public Accountants

15. Appendix D To Part 1773 is added to read as follows:

Appendix D to Part 1773—Illustrative Independent Auditor's Management Letter for Telecommunications Borrowers

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

Illustrative Independent Auditor's Management Letter for Telecommunications Borrowers

March 2, 1999

Board of Directors

[Name of Borrower]
[City, State]

We have audited the financial statements of [Name of Borrower] for the year ended December 31, 1998, and have issued our report thereon dated March 2, 1999. We conducted our audit in accordance with generally accepted auditing standards, the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States, and 7 CFR part 1773, Policy on Audits of Rural Utilities Service (RUS) Borrowers. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

In planning and performing our audit of the financial statements of [Name of Borrower] for the year ended December 31,

1998, we considered its internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the internal control over financial reporting.

A description of the responsibility of management for establishing and maintaining the internal control over financial reporting and the objectives of and inherent limitations in such control is set forth in our independent auditors' report on compliance and on internal control over financial reporting dated March 2, 1999, and should be read in conjunction with this report.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting that we consider to be material weaknesses. [If a material weakness was noted, refer the reader to the independent auditors' report on compliance and on internal control over financial reporting.]

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

No reports (other than our independent auditors' report, and our independent auditors' report on compliance and on internal control over financial reporting, all dated March 2, 1999) or summary of recommendations related to our audit have been furnished to management.

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

Comments On Certain Specific Aspects of the Internal Control Over Financial Reporting

We noted no matters regarding [Name of Borrower]'s internal control over financial reporting and its operation that we consider to be a material weakness as previously defined with respect to:

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

Comments On Compliance With Specific RUS Loan and Security Instrument Provisions

Management's responsibility for compliance with laws, regulations, contracts, and grants is set forth in our independent auditors' report on compliance and on internal control over financial reporting dated March 2, 1999, and should be read in conjunction with this report. At your request, we have performed the procedures enumerated below with respect to compliance with certain provisions of laws, regulations, contracts, and grants. The procedures we performed are summarized as follows:

- Procedure performed with respect to the requirement to maintain all funds in institutions whose accounts are insured by an Agency of the Federal government:
 1. Obtained information from financial institutions with which [Name of Borrower] maintains funds that indicated that the institutions are insured by an agency of the Federal government.
- Procedures performed with respect to the requirement for a borrower to obtain written approval of the mortgagee to enter into any contract for the operation or maintenance of property, for the use of mortgaged property by others, or for services pertaining to toll traffic, operator

assistance, or switching for the year ended December 31, 1998 of [Name of Borrower]:

1. Obtained and read a borrower-prepared schedule of new written contracts entered into during the year for the operation or maintenance of its property, for the use of its property by others, or for services pertaining to toll traffic, operator assistance, or switching as defined in § 1773.33 (e)(2)(i).
2. Reviewed Board of Director minutes to ascertain whether board-approved written contracts are included in the borrower-prepared schedule.
3. Noted the existence of written RUS [and other mortgagee] approval of each contract listed by the borrower.

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

1. Agreed amounts reported in Form 479 to [Name of Borrower]'s records.
- Procedure performed with respect to funded reserve and net plant to secured debt ratio requirements:

1. Reviewed loan security instrument to ascertain which condition was elected by the borrower.
2. If the funded reserve option was selected, review financial institution records to verify the existence of a separate bank account for the reserve, and determine that it was funded within one year of approval of release of funds and that it remained funded over the composite economic life of the facilities financed.
3. If the net plant to secured debt ratio option was selected, calculate the ratio and confirm that the 1.2 ratio was achieved one year following the first advance of loan funds.

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

- The borrower maintains all funds in institutions whose accounts are insured by an agency of the Federal government [list all exceptions];
- The borrower has obtained written approval of the RUS [and other mortgagees] to enter into any contract for the operation or maintenance of property, for the use of

mortgaged property by others, or for services pertaining to toll traffic, operator assistance, or switching as defined in § 1773.33(e)(2)(i) [list all exceptions]; and

- The borrower has submitted its Form 479 to the RUS and the Form 479, Financial and Statistical Report, as of December 31, 1999, represented by the borrower as having been submitted to RUS is in agreement with the [Name of Borrower]'s audited records in all material respects [list all exceptions] [or if the audit year end is other than December 31], appears reasonable based upon the audit procedures performed [list all exceptions].

Comments on Other Additional Matters

In connection with our audit of the financial statements of [Name of Borrower], nothing came to our attention that caused us to believe that [Name of Borrower] failed to comply with respect to:

- The reconciliation of subsidiary plant records to the controlling general ledger plant accounts addressed at 7 CFR 1773.33(c)(1) [list all exceptions];
- The clearing of the construction accounts and the accrual of depreciation on completed construction addressed at 7 CFR 1773.33(c)(2) [list all exceptions];
- The retirement of plant addressed at 7 CFR 1773.33(c)(3) and (4) [list all exceptions];
- Sales of plant material, or scrap addressed at 7 CFR 1773.33(c)(5) [list all exceptions]; and
- The disclosure of material related party transactions, in accordance with Statement of Financial Accounting Standards No. 57, Related Party Transactions, for the year ended December 31, 1999, in the financial statements referenced in the first paragraph of this report addressed at 7 CFR 1773.33(f) [list all exceptions].

This report is intended solely for the information and use of the board of directors, management, and the RUS and supplemental lenders. However, this report is a matter of public record and its distribution is not limited.

Certified Public Accountants

Dated: July 8, 1998.

Jill Long Thompson,

Under Secretary, Rural Development.

[FR Doc. 98-18758 Filed 7-16-98; 8:45 am]

BILLING CODE 3410-15-P