

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

1. Agreed amounts reported in Form 479 to Center County Telecommunications Systems, Inc.'s records.

The results of our tests indicate that, with respect to the items tested, Center County Telecommunications Systems, Inc. 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 has obtained written approval of the RUS [and other mortgagees] to enter into any contract agreement or lease with an affiliate 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, 2001, represented by the borrower as having been submitted to RUS in agreement with the Center County Telecommunications Systems, Inc.'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 Center County Telecommunications Systems, Inc., nothing came to our attention that caused us to believe that Center County Telecommunications Systems, Inc. failed to comply with respect to:

- The reconciliation of continuing property records to the controlling general ledger plant accounts addressed at § 1773.33(c)(1) [list all exceptions];
- The clearing of the construction accounts and the accrual of depreciation on completed construction addressed at § 1773.33(c)(2) [list all exceptions];
- The retirement of plant addressed at § 1773.33(c)(3) and (4) [list all exceptions];
- The approval of the sale, lease, or transfer of capital assets and disposition of proceeds for the sale of lease of plant, material, or scrap addressed at § 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, 2001, in the financial statements referenced in the first paragraph of this report addressed at § 1773.33(f) [list all exceptions]; and
- The detailed schedule of investments.

Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The detailed schedule of investments required by § 1773.33(i) 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 investments would be included here. The total of the investment in each company reported must agree with the detail investment subsidiary accounts.]

This report is intended solely for the information and use of the board of directors, management, and the RUS and supplemental lenders and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Certified Public Accountants

[FR Doc. 01–12129 Filed 5–18–01; 8:45 am]

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DEPARTMENT OF AGRICULTURE

Rural Utilities Service

7 CFR Part 1773

RIN 0572–AB62

Policy on Audits of RUS Borrowers; Generally Accepted Government Auditing Standards (GAGAS)

AGENCY: Rural Utilities Service, USDA.

ACTION: Direct final rule.

SUMMARY: The Rural Utilities Service (RUS) is amending its regulations to include in its audit requirements for electric and telecommunications borrowers recent amendments to the Generally Accepted Government Auditing Standards (GAGAS) issued by the Government Accounting Office (GAO) and to make other minor changes and corrections.

DATES: This rule will become effective July 5, 2001 unless we receive written adverse comments or written notice of intent to submit adverse comments on or before June 20, 2001. If we receive such comments or notice, we will publish a timely document in the **Federal Register** withdrawing the rule. A second public comment period will not be held. Parties interested in commenting on this action should do so at this time.

ADDRESSES: Submit adverse comments or notice of intent to submit adverse comments to F. Lamont Heppe, Jr., Director, Program Development and Regulatory Analysis, Rural Utilities Service, U.S. Department of Agriculture, 1400 Independence Ave., SW., STOP 1522, Washington, DC 20250–1522. RUS requests a signed original and three copies of all comments (7 CFR 1700.4). All comments received will be made available for public inspection at room 4030, South Building, Washington, DC,

between 8 a.m. and 4 p.m. (7 CFR 1.27(b)).

FOR FURTHER INFORMATION CONTACT:

Richard Annan, Chief, Technical Accounting and Auditing Staff, Program Accounting Services Division, Rural Utilities Service, U.S. Department of Agriculture, 1400 Independence Ave., SW., STOP 1523, Washington, DC 20250–1523. Telephone: 202–720–5227.

SUPPLEMENTARY INFORMATION:

Executive Order 12866

This rule has been determined to be not significant for the purposes of Executive Order 12866 and, therefore, has not been reviewed by the Office of Management and Budget (OMB).

Executive Order 12372

This rule is excluded from the scope of Executive Order 12372, Intergovernmental Consultation, which may require consultation with state and local offices. See the final rule related notice entitled “Department Programs and Activities Excluded from Executive Order 12372,” (50 FR 47034).

Executive Order 12988

This rule has been reviewed under Executive Order 12988, Civil Justice Reform. RUS has determined that this rule meets the applicable standards provided in section 3 of the Executive Order. In addition, all State and local laws and regulations that are in conflict with this rule will be preempted; no retroactive effect will be given to this rule; and, in accordance with section 212(e) of the Department of Agriculture Reorganization Act of 1994 (7 U.S.C. 6912(e)) administrative appeal procedures, if any are required, must be exhausted before an action against the Department or its agencies.

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.*). The RUS loan programs provide borrowers with loans at interest rates and terms that are more favorable than those generally available from the private sector. Borrowers, as a result of obtaining federal financing, receive economic benefits that exceed any direct cost associated with RUS regulations and requirements.

National Environmental Policy Act Certification

The Administrator of RUS has determined that this 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 rule is listed in the Catalog of Federal Domestic Assistance programs under Nos. 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 20402-9325, telephone number (202) 512-1800.

Information Collection and Recordkeeping Requirements

The reporting and recordkeeping requirements contained in this rule has been approved by the Office of Management and Budget (OMB) under OMB Control Number 0572-0095, pursuant to the Paperwork Reduction Act of 1995 (44 U.S.C chapter 35).

Send questions or comments regarding this burden or any other aspect of these collections of information, including suggestions for reducing the burden, to F. Lamont Hepe, Jr., Director, Program Development and Regulatory Analysis, Rural Utilities Service, USDA, 1400 Independence Ave., SW, Stop 1522, Washington, DC 20250-1522.

Unfunded Mandates

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

Background

Title 7 part 1773 implements the standard RUS security instrument provision requiring RUS electric and telecommunications borrowers to prepare and furnish to RUS, at least once during each 12-month period, a full and complete report of their financial condition, operations, and cash flows, in form and substance satisfactory to RUS; audited and certified by an independent Certified Public Accountant (CPA), satisfactory to RUS, and accompanied by a report of such audit, in form and substance satisfactory to RUS.

This rule amends part 1773 to reflect two amendments to Generally Accepted Government Auditing Standards (GAGAS) adopted in 1999 by the General Accounting Office (GAO): Amendment No. 1 to GAGAS, dated May 13, 1999, and Amendment No. 2 to GAGAS, dated July 30, 1999.

Amendment No. 1 to GAGAS established a new field work standard that requires auditors to document in the working papers the basis for assessing control risk at the maximum level for assertions related to material accounts balances, transaction classes, and disclosure components of financial statements when such assertions are significantly dependent on computerized information systems. The new standard also requires the auditors to document their consideration that the planned audit procedures are designed to achieve audit objectives and to reduce audit risk to an acceptable level. These new requirements are achieved through compliance with §§ 1773.7(a) and 1773.7(b).

Amendment No. 2 to GAGAS created a new fieldwork standard for planning titled "Auditor Communication" by moving and expanding an existing standard from the reporting standards. This rule revises § 1773.6 to comply with this new standard. Amendment No. 2 also changed the term "irregularities" to "fraud" in regards to the requirements for reporting on compliance with laws and regulations and internal control over financial reporting. This rule revises § 1773.9 to incorporate this change in terminology. Finally, GAGAS requires the auditor to emphasize in the auditor's report the importance of the report on compliance and on internal control over financial reporting when this report is issued separately from the report on the financial statements. This rule revises § 1773.31, to incorporate this requirement into the auditor's report.

On July 17, 1998, RUS issued, as a final rule, 7 CFR part 1773 (63 FR 38720) which incorporated the 1994 revisions of GAGAS. Those 1994 GAGAS revisions, as well as the 1999 amendments noted above, revised and updated some of the standard terminology used to describe the requirements for performing audits in conformance with GAGAS. This rule updates the appropriate sections of this part to conform to the GAGAS requirements.

The 1998 revisions to part 1773 combined the separate report on compliance and report on internal control into a single report titled "Reports on Compliance and on Internal Control Over Financial Reporting". In

making the changes to substitute the combined report in the appropriate sections of part 1773, the references to the separate report on compliance were not removed thus leading the reader to conclude that the separate report on compliance was still required. This rule eliminates all the references to the report on compliance. In addition, the 1998 revision references to the telephone program were changed to telecommunications program. Not all of the references were changed and this rule will serve to make those additional corrections. The 1998 revision also reduced, from 42 months to 36 months, the period of time required in which the CPA must undergo the issuance of a new peer review. Two references to the 42-month requirement in § 1773.5(c) that were missed in the 1998 final rule are revised with this rule.

This rule adds, changes, and deletes definitions to reflect the GAGAS amendments noted above as well as the changing structure of the RUS organization and its policies and procedures. A definition is added for Assistant Administrator, Program Accounting and Regulatory Analysis, to replace the Director, Program Accounting Services Division. The name of the Borrower Accounting Division was changed to Program Accounting Services Division in the 1998 rule, but the definition was not removed from § 1773.2, Definitions. The definition of "irregularity" is replaced with the definition of "fraud" to conform to the changes made in Amendment No. 2 to GAGAS. The definition of the Private Companies Practice Section (PCPS) is removed. The peer review program conducted by this group was combined with the American Institute of Certified Public Accountants' (AICPA) quality review program in 1995, thus the reference to the PCPS is removed. The definition of REA is eliminated, as it is no longer necessary. The definition of Uniform System of Accounts for Electric Borrowers is revised to include the complete citation of the requirement to maintain a uniform system of accounts prescribed by RUS (7 CFR Part 1767, Accounting Requirements for RUS Electric Borrowers, Subpart B, Uniform System of Accounts). This rule amends § 1773.2, to reflect these changes.

Section 1773.1(d)(6) provides that a report described in the Statement on Auditing Standards (SAS) No. 35 does not meet the audit requirement of RUS. This SAS was superseded and retitled with the issuance of SAS No. 75.

In previous versions of part 1773 the sample reports, financial statements, and management letters were contained

in four appendices, two for electric borrowers and two for telecommunications borrowers. Beginning with this revision of part 1773, the appendices will no longer be codified in the Code of Federal Regulations. The appendices are attached to this notice for information only. The appendices are sample formats to be used as a reference guide to assist CPAs in completing their reports. The appendices will be available in new RUS Bulletin 1773-1, which will contain all of 7 CFR part 1773 and the appendices. Appendix A will contain the sample reports, financial statements and management letter for electric borrowers while

Appendix B will contain similar samples for telecommunications borrowers. Publishing part 1773 in bulletin form will provide the RUS audit policy in a user-friendly format. A single copy of this publication will be provided to all RUS borrowers and certified public accountants approved to perform audits of RUS borrowers and will be available at <http://www.usda.gov/rus/ruswide.htm>.

List of Subjects in 7 CFR Part 1773

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

For the reasons set forth in the preamble, RUS amends 7 CFR Chapter XVII as follows:

PART 1773—POLICY ON AUDITS OF RUS BORROWERS

1. The authority citation for Part 1773 is revised to read as follows:

Authority: 7 U.S.C. 901 *et seq.*, 1921 *et seq.*, 6941 *et seq.*

§§ 1773.1 through 1773.7, 1773.20, 1773.21, 1773.30, and 1773.38 [Amended]

2. For each section listed below remove the word, phrase, or date indicated in the remove column, and replace it with that indicated in the add column.

Section	Remove	Add
§ 1773.1(a), two occurrences of § 1773.2, under definition for RUS.	telephone	telecommunications.
§ 1773.1(d); § 1773.3(c); §§ 1773.4 (f), (f)(1), and (g); § 1773.6 (a)(1) and (a)(4); §§ 1773.20, (a), (b), and (c)(6); § 1773.21, (a), and (b); § 1773.30(b); § 1773.38(b).	report on compliance, report on compliance and on internal controls over financial reporting.	report on compliance and on internal control over financial reporting.
§ 1773.8(a)(2) and (c)	19X1	20X1.
§ 1773.8(a)(2) and (c)	19X3	20X3.
§ 1773.6(a)(7)	irregularities	fraud.

3. Section 1773.1(c) and (d)(6) are revised to read as follows:

§ 1773.1 General.

* * * * *

(c) This complies with the 1994 revision of Government Auditing Standards, issued by the Comptroller General of the United States, United States General Accounting Office, including amendments dated May 13, 1999, and July 30, 1999.

(d) * * *

(6) A report, as described in Statement on Auditing Standards (SAS) No. 62, entitled "Special Reports", or in SAS No. 75, entitled "Engagements to Apply Agreed-upon Procedures to Specified Elements, Accounts, or Items of a Financial Statement", does not satisfy the RUS loan security instrument requirements.

* * * * *

4. Section 1773.2 is amended by:

A. Removing the definitions for "BAD", "Irregularity", "PCPS", and "REA"

B. Revising the definition for "Uniform System of Accounts" and

C. Adding new definitions for "AA-PARA", "Fraud", and "RUS Bulletin 1773-1".

The new and revised definitions to read as follows:

§ 1773.2 Definitions.

* * * * *

AA-PARA means Assistant Administrator, Program Accounting and Regulatory Analysis.

* * * * *

Fraud has the same meaning prescribed in SAS No. 82 entitled "Consideration of Fraud in Financial Statements".

* * * * *

RUS Bulletin 1773-1, Policy on Audits of RUS Borrowers, is a publication prepared by RUS that contains the RUS regulation 7 CFR part 1773 and exhibits of sample audit reports, financial statements, and a management letter used in preparing audit of RUS borrowers. This bulletin is available from USDA, Rural Utilities Service, Program Development and Regulatory Analysis, 1400 Independence Ave., SW., Stop 1522, Washington, DC 20250, or available on the internet at <http://www.usda.gov/rus/>.

* * * * *

Uniform System of Accounts means, for telecommunications borrowers, the Uniform System of Accounts for Telecommunications Companies, prescribed by the Federal Communications Commission and published at 47 CFR Part 32, as supplemented by RUS pursuant to 7 CFR Part 1770, Accounting Requirements for RUS Telephone Borrowers, subpart B, Uniform System of Accounts, and for electric borrowers,

as contained in 7 CFR Part 1767, Accounting Requirements for RUS Electric Borrowers, subpart B, Uniform System of Accounts.

5. Revise § 1773.3(b) to read as follows:

§ 1773.3 Annual audit.

* * * * *

(b) Each borrower must establish an annual as of audit date within twelve months of the date of receipt of the first advance of funds from grants and insured and guaranteed loans approved by RUS and RTB and must prepare financial statements as of the date established.

* * * * *

6. Revise § 1773.4(d) to read as follows:

§ 1773.4 Borrower responsibilities.

* * * * *

(d) *Audit engagement letter.* The borrower must enter into an audit engagement letter with the CPA that complies with § 1773.6.

* * * * *

§ 1773.5 [amended]

7. Amend § 1773.5 by:

A. Removing paragraphs (c)(5) and (d);

B. Redesignating paragraphs (c)(6) and (c)(7) to (c)(5) and (c)(6), respectively;

C. In paragraph (c)(4)(iii)(C) and redesignated (c)(5)(ii), revising the

reference “42 months” to read “36 months”, and

D. In redesignated paragraph (c)(6)(ii), revising the reference from “Director, Borrower Accounting Division” to read “Assistant Administrator, Program Accounting and Regulatory Analysis”.

8. Amend § 1773.6 by revising the title and paragraph (a) introductory text to read as follows:

§ 1773.6 Auditor communication.

(a) During the planning stages of a financial statement audit, GAGAS and AICPA standards require the auditor to communicate certain information regarding the nature and extent of testing and reporting on compliance with laws and regulations and internal control over financial reporting. The communication must include the nature of any additional testing of compliance and internal control required by laws and regulations or otherwise requested, and whether the auditors are planning to provide opinions on compliance with laws and regulations and internal control over financial reporting. This communication must take the form of an audit engagement letter prepared by the CPA and formally accepted by the board of directors or an audit committee representing the board of directors. The engagement letter must also encompass those items prescribed in SAS 83, entitled “Establishing an Understanding with the Client”. It must also include the following:

* * * * *

9. In § 1773.7, paragraphs (b) and (c)(4) are revised to read as follows:

§ 1773.7 Audit standards.

* * * * *

(b) The audit must include such tests of the accounting records and such other auditing procedures that are sufficient to enable the CPA to express an opinion on the financial statements and to issue the required report on compliance and on internal control over financial reporting and the management letter.

(c) * * *

(4) After informing the borrower’s management, if the scope limitation is not adequately resolved, the CPA should immediately contact the AA-PARA, RUS, U.S. Department of Agriculture, Washington, DC 20250-1523. The AA-PARA will endeavor to resolve the matter with the borrower.

10. In § 1773.8, paragraphs (a)(1) and the table following paragraph (c) are revised to read as follows:

§ 1773.8 Audit date.

(a) * * *

(1) A borrower may request a change in the as of audit date by writing to the AA-PARA at least 60 days prior to the newly requested as of audit date.

* * * * *

(c) * * *

Previously issued statements	Statements prepared as of new audit date
12/31/20X1; 12/31/20X0 (Statement need not be re-issued).	6/30/20X3; 6/30/20X2.

11. Amend § 1773.9 by revising the title and paragraphs (a), (b), and (c) introductory text, to read as follows:

§ 1773.9 Disclosure of fraud, illegal acts, and other noncompliance.

(a) In accordance with GAGAS, the auditor must design the audit to provide reasonable assurance of detecting fraud that is material to the financial statements and material misstatements resulting from direct and material illegal acts, and noncompliance with the provisions of contracts or grant agreements that could have a direct and material effect on financial statements amounts.

(b) If specific information comes to the auditor’s attention that provides evidence concerning the existence of possible illegal acts that could have a material indirect effect on the financial statements or material noncompliance with the provisions of contracts or grant agreements that could have a material indirect effect on the financial statements, auditors should apply audit procedures specifically directed to ascertaining whether an illegal act or noncompliance with provisions of contract or grant agreements has occurred.

(c) Pursuant to the terms of its audit engagement letter with the borrower, the CPA must immediately report, in writing, all instances of fraud and all indications or instances of illegal acts, whether material or not, to:

* * * * *

12. Revise the title to subpart C to part 1773, to read as follows:

Subpart C—RUS Requirements for the Submission and Review of the Auditor’s Report, Report on Compliance and on Internal Control Over Financial Reporting, and Management Letter

13. In § 1773.21, revise the title and add a new paragraph (e) to read as follows:

§ 1773.21 Borrower’s review and submission of the auditor’s report, report on compliance and on internal control over financial reporting, and management letter.

* * * * *

(e) All required submissions to RUS described in paragraphs (a) through (d) of this section should be sent to: Assistant Administrator, Program Accounting and Regulatory Analysis, Stop 1523, 1400 Independence Ave., SW, Washington, DC 20250-1523.

14. Section 1773.30 paragraph (a) is revised to read as follows:

§ 1773.30 General.

(a) The CPA must prepare the following (examples of which are set forth in RUS Bulletin 1773-1):

- (1) An auditor’s report;
- (2) A report on compliance and on internal control over financial reporting; and
- (3) A management letter.

* * * * *

15. Section 1773.31 is revised to read as follows:

§ 1773.31 Auditor’s report.

The CPA must prepare a written report on comparative balance sheets, statements of revenue and patronage capital (or income and retained earnings, depending upon the structure of the borrower) and statements of cash flows. 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. The auditor’s report should also state that the report on compliance and on internal control over financial reporting is an integral part of a GAGAS audit, and in considering the results of the audit, this report should be read along with the auditor’s report on the financial statements.

16. Amend § 1773.32 by revising the introductory text, paragraphs (a) through (d), and the “note” at the end of paragraph (f) 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 describing the auditors testing of compliance with applicable laws, regulations, contracts, and grants, and on internal control over financial reporting and present the results of those tests. This report must be signed by the CPA and must include, as a minimum:

(a) The scope of the CPA’s testing of compliance with laws and regulations and internal control over financial reporting including whether or not the

tests performed provided sufficient evidence to support an opinion on compliance or internal control over financial reporting and whether the CPA is providing such opinions;

(b) If conditions believed to be material weaknesses considered to be reportable conditions are disclosed, the report should identify the material weaknesses that have come to the CPA's attention;

(c) If no reportable instances of non-compliance and no reportable conditions were found, the CPA must issue a report as illustrated in RUS Bulletin 1773-1.

(d) If material instances of non-compliance and reportable conditions are identified, the CPA must issue a report as illustrated in RUS Bulletin 1773-1.

* * * * *

(f) * * *

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

* * * * *

17. Remove Appendices A through D to part 1773.

Dated: May 8, 2001.

Blaine D. Stockton,

Acting Administrator, Rural Utilities Service.

Appendix A to RUS Bulletin 1773-1— Sample Auditor's Report for an Electric Cooperative

Appendix A includes an example of an auditor's report, report on compliance and on internal control over financial reporting, financial statements and accompanying notes, and management letter for an electric distribution cooperative. The sample auditor's report is intended as a guide only and, while it is recommended that the format be followed, each auditor's report should be prepared to adequately cover the circumstances. To the extent possible, it should be used as a guide in preparing auditors' reports for other types of electric borrowers. For power supply borrowers and for distribution borrowers with production or transmission plant, the same general format should be followed. However, the Statement of Revenue and Patronage Capital must be expanded to show separate totals for operations expenses and maintenance expenses for each class of production plant and for transmission plant.

Exhibit 1—Sample Auditor's Report

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

We have audited the accompanying balance sheets of Center County Electric Energy Association, Inc. as of December 31, 20X1 and 20X0, 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 Energy Association, Inc.'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 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 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 Energy Association, Inc. as of December 31, 20X1 and 20X0, 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 our report dated March 2, 2002, on our consideration of Center County Electric Energy Association, Inc.'s internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.
Certified Public Accountants
March 2, 20X2

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 Energy Association, Inc.:

We have audited the financial statements of Center County Electric Energy Association, Inc. as of and for the years ended December 31, 20X1 and 20X0, and have issued our report thereon dated March 2, 20X2. 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 Energy Association, Inc.'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 Energy Association, Inc. in a separate letter dated March 2, 20X2.]

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Center County Electric Energy Association, Inc.'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 Energy Association, Inc. in a separate letter dated March 2, 20X2.]

This report is intended solely for the information and use of the audit committee, management, the Rural Utilities Service, and supplemental lenders and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.
Certified Public Accountants
March 2, 20X2

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 Energy Association, Inc.:

We have audited the financial statements of Center County Electric Energy Association, Inc. as of and for the years ended December 31, 20X1 and 20X0, and have issued our report thereon dated March 2, 20X2. 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 Energy Association, Inc.'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 Energy Association, Inc. in a separate letter dated March 2, 20X2.]

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Center County Electric Energy Association, Inc.'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 Energy Association, Inc.'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 Energy Association, Inc. in a separate letter dated March 2, 2002.]

This report is intended solely for the information and use of the audit committee, management, the Rural Utilities Service, and supplemental lenders and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Certified Public Accountants
March 2, 2002

Exhibit 4—Sample Financial Statements

CENTER COUNTY ELECTRIC ENERGY ASSOCIATION, INC. BALANCE SHEETS DECEMBER 31, 20X1 AND 20X0 ASSETS
[Notes 1 and 2]

	2001	2000
Utility Plant (Note 3):		
Electric Plant in Service	\$48,382,000	\$46,826,000
Construction Work in Progress	2,040,000	1,586,000
Total Utility Plant	50,422,000	48,412,000
Accumulated Provision for Depreciation	15,588,000	14,586,000
Net Utility Plant	34,834,000	33,826,000
Investments (Note 4):		
Investments in Associated Organizations	4,493,000	4,048,000
Other	1,040,000	1,410,000
Total Investments	5,533,000	5,458,000
Current Assets:		
Cash and Cash Equivalents	359,000	359,000
Short-Term Investments (Note 4)	8,000	8,000
Accounts Receivable, less allowance for doubtful accounts of \$11,000 in 2001 and \$10,000 in 2000	183,000	176,000
Materials and supplies	418,000	404,000
Prepayments	43,000	43,000
Total current assets	1,011,000	990,000
Deferred Charges (Note 5)	28,000	9,000
Total assets	\$41,406,000	\$40,283,000

The accompanying notes are an integral part of these statements.

CENTER COUNTY ELECTRIC ENERGY ASSOCIATION, INC. BALANCE SHEETS DECEMBER 31, 20X1 AND 20X0
[Equities and Liabilities] [Note 1]

	20X1	20X0
Equities:		
Memberships	\$60,000	\$59,000
Patronage Capital (Note 6)	16,683,000	15,343,000
Other Equities (Note 7)	268,000	180,000
Net Unrealized Gain on Investments (Note 4)	15,000	8,000
Total Equities	17,026,000	15,590,000
Long-term liabilities:		
RUS Mortgage Notes, less current portion (Note 8)	16,956,000	17,532,000
CFC Mortgage Notes, less current portion (Note 8)	4,333,000	4,482,000
Post-retirement benefit obligation (Note 9)	1,004,000	841,000
Total Long-term liabilities	22,293,000	22,855,000
Current Liabilities:		
Line of credit note payable	425,000	300,000
Current portion of long-term debt (Note 8)	725,000	700,000
Accounts Payable—Purchased Power	245,000	203,000
Accounts Payable—Other	109,000	91,000
Consumer Deposits	408,000	413,000
Other Current and Accrued Liabilities	116,000	78,000
Total Current Liabilities	2,028,000	1,785,000
Deferred Credits (Note 10)	59,000	53,000
Total Equities and Liabilities	\$41,406,000	\$40,283,000

The accompanying notes are an integral part of these statements.

CENTER COUNTY ELECTRIC ENERGY ASSOCIATION, INC. STATEMENTS OF REVENUE AND PATRONAGE CAPITAL
[For the years ended December 31, 20X1 and 20X0]

	20X1	20X0
Operating Revenues	\$12,899,000	\$12,042,000
Operating Expenses:		
Cost of Power	4,408,000	4,095,000
Distribution Operations	833,000	913,000
Distribution Maintenance	1,553,000	1,236,000
Consumer Accounts	575,000	547,000
Consumer Service and Information	288,000	306,000
Administrative and General	710,000	653,000
Depreciation and Amortization	2,163,000	2,098,000
Other	262,000	258,000
Total Operating Expenses	10,792,000	10,106,000
Operating Margins Before Interest Expense	2,107,000	1,936,000
Interest Expense	1,137,000	1,151,000
Operating Margins After Interest Expense	970,000	785,000
Nonoperating Margins:		
Interest Income	50,000	30,000
Other Nonoperating Income	6,000	6,000
Total Nonoperating Margins	56,000	36,000
Generation and Transmission Cooperative Capital Credits	361,000	283,000
Net Margins	1,387,000	1,104,000
Patronage Capital at Beginning of Year	15,343,000	14,345,000
Less: Retirements of Capital Credits	47,000	106,000
Patronage Capital at End of Year	\$16,683,000	\$15,343,000

The accompanying notes are an integral part of these statements.

CENTER COUNTY ELECTRIC ENERGY ASSOCIATION, INC. STATEMENTS OF COMPREHENSIVE INCOME FOR THE YEARS
ENDED DECEMBER 31, 20X1 AND 20X0

	20X1	20X0
Net Margins	\$1,387,000	\$1,104,000
Other Comprehensive Income:		
Unrealized holding gains (losses) arising during the year	7,000	8,000
Comprehensive Income	\$1,394,000	\$1,112,000

The accompanying notes are an integral part of these statements.

CENTER COUNTY ELECTRIC ENERGY ASSOCIATION, INC. STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED
DECEMBER 31, 20X1 AND 20X0

	20X1	20X0
Cash Flows From Operating Activities:		
Cash Received from Consumers	\$12,882,000	\$12,017,000
Cash Paid to Suppliers and Employees	(8,335,000)	(7,784,000)
Interest Received	50,000	30,000
Interest Paid	(1,137,000)	(1,151,000)
Net Cash Provided by Operating Activities	3,460,000	3,112,000
Cash Flows From Investing Activities:		
Construction and Acquisition of Plant	(2,010,000)	(3,285,000)
Plant Removal Costs	(1,378,000)	(270,000)
Materials Salvaged from Retirements	217,000	197,000
(Increase) Decrease In:		
Materials Inventory	(14,000)	10,000
Deferred Charges-Preliminary Surveys and Investigations	(19,000)	24,000
Investments in Associated Organizations	(76,000)	(56,000)
Other Investments	370,000	323,000
Inventory Adjustment-Deferred Credit Decrease	(12,000)	(5,000)
Net Cash Used in Investing Activities	(2,922,000)	(3,062,000)
Cash Flows From Financing Activities:		
Retirements of Patronage Capital Credits	(47,000)	(106,000)
Retired Capital Credits-Gain	6,000	6,000
Donated Capital	82,000	31,000
RUS Loan Advances .....	.....	1,025,000
Payments on RUS Debt	(540,000)	(502,000)
Payments on CFC Debt	(160,000)	(149,000)
Line of Credit	125,000	(225,000)
Increase/(Decrease) In:		
Consumer Deposits	(5,000)	(1,000)
Memberships Issued	1,000	1,000
Net Cash Used in Financing Activities	(538,000)	80,000
Net Increase/(Decrease) in Cash	\$0	\$130,000
Cash—Beginning of Year	359,000	229,000
Cash—End of Year	\$359,000	\$359,000

RECONCILIATION OF NET MARGINS TO NET CASH PROVIDED BY OPERATING ACTIVITIES

	20X1	20X0
Net Margins	\$1,387,000	\$1,104,000
Adjustments to Reconcile Net Margins to Net Cash Provided by Operating Activities:		
Depreciation and Amortization	2,163,000	2,098,000
G&T and Other Capital Credits (Non-Cash)	(362,000)	(283,000)
Provision for Uncollectible Accounts Receivable	1,000	(3,000)
Accumulated Provision for Pensions and Benefits	163,000	150,000
(Increase)/Decrease In:		
Customer and Other Accounts Receivable	(8,000)	13,000
Current and Accrued Assets—Other .....	.....	1,000
Increase/(Decrease) In:		
Accounts Payable	60,000	26,000
Deferred Energy Prepayments	18,000	11,000

RECONCILIATION OF NET MARGINS TO NET CASH PROVIDED BY OPERATING ACTIVITIES—Continued

	20X1	20X0
Current and Accrued Liabilities—Other	38,000	(5,000)
Total Adjustments	2,073,000	2,008,000
Net Cash Provided by Operating Activities	\$3,460,000	\$3,112,000

The accompanying notes are an integral part of these statements.

CENTER COUNTY ELECTRIC ENERGY ASSOCIATION, INC. NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 20X1 AND 20X0

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 and NRUCFC.

3. Electric Plant and Depreciation Rates and Procedures:

Listed below are the major classes of the electric plant as of December 31, 20X1 and 20X0:

	20X1	20X0
Intangible Plant	\$11,000	\$11,000
Distribution Plant	45,753,000	44,370,000
General Plant	2,618,000	2,445,000
Electric Plant in Service	\$48,382,000	\$46,826,000
Construction Work in Progress	2,040,000	1,586,000
Total Utility Plant	\$50,422,000	\$48,412,000

Provision has been made for depreciation of distribution plant at a straight-line composite rate of 3.00 percent per annum. General Plant depreciation rates have been applied on a straight-line basis as follows:

Structures and Improvements	2.5%
Office Furniture and Equipment	10.0%
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 20X1 and 20X0:

	20X1	20X0
National Rural Utilities Cooperative Finance Corporation:		
Membership Fee	\$1,000	\$1,000
Capital Term Certificates	839,000	839,000
Patronage Capital	288,000	276,000
Fall River Power Cooperative	3,019,000	2,898,000
Other	346,000	34,000
	\$4,493,000	\$ 4,048,000

Center County Electric Energy Association, Inc. has adopted SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities." In accordance with SFAS No. 115, the Association has classified all the Other Investments as available-for-sale. Available-for-sale investments are stated at fair value with unrealized gains and losses included in members' equities. The cost of investments sold is based on the specific identification method.

Long-term and short-term investments classified as available-for-sale were as follows at December 31, 20X1 and 20X0:

Description	20X1			Fair value
	Amortized cost	Gross unrealized gain	Gross unrealized loss	
U.S. Treasury notes, bills and bonds	\$222,000	\$14,000	\$1,000	235,000
Other U.S. Government agency securities	380,000	6,000	4,000	382,000

Description	20X1			
	Amortized cost	Gross unrealized gain	Gross unrealized loss	Fair value
Other debt securities	431,000	3,000	3,000	431,000
	\$1,033,000	\$23,000	\$8,000	\$1,048,000

Description	20X0			
	Amortized cost	Gross unrealized gain	Gross unrealized loss	Fair value
U.S. Treasury notes, bills and bonds	\$397,000	\$5,000	\$1,000	\$401,000
Other U.S. Government agency securities	410,000	2,000	.....	412,000
Other debt securities	604,000	1,000	.....	605,000
	\$1,411,000	\$8,000	\$1,000	\$1,418,000

At December 31, 20X1, maturities of investments classified as available-for-sale were as follows:

	Amortized cost	Fair value
Less than One Year	\$8,000	\$8,000
One through Five Years	958,000	961,000
After Five Years	67,000	79,000
Total	\$1,033,000	\$1,048,000

5. Deferred Charges:

Following is a summary of amounts recorded as deferred charges as of December 31, 20X1 and 20X0:

	20X1	20X0
Preliminary Surveys and Investigations	\$28,000	\$9,000

6. Patronage Capital:

At December 31, 20X1 and 20X0, patronage capital consisted of:

	20X1	20X0
Assignable	\$1,387,000	\$1,104,000
Assigned to date	15,955,000	14,851,000
	\$17,342,000	\$15,955,000
Less: Retirements to Date	659,000	612,000
	\$16,683,000	\$15,343,000

Under the provisions of the Mortgage Agreement, until the equities and margins equal or exceed thirty 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 41 percent of the total assets at balance sheet date. Capital credit retirements in the amount of \$47,000 were paid in 20X1.

7. Other Equities:

At December 31, 20X1 and 20X0, other equities consisted of:

	20X1	20X0
Retired Capital Credits-Gain	\$181,000	\$175,000
Donated Capital	87,000	5,000
	\$268,000	\$180,000

8. Mortgage Notes:

Long-term debt is primarily represented by mortgage notes payable to the United States of America and to the National Rural Utilities Cooperative Finance Corporation. Following is a summary of outstanding long-term debt as of December 31, 20X1 and 20X0:

	20X1	20X0
RUS, 2% Notes due March 31, 2007	\$544,000	\$562,000
RUS, 5% Notes due December 31, 2033	16,971,000	17,510,000
	\$17,515,000	\$18,072,000
Less: Current Maturities	559,000	540,000
	\$16,956,000	\$17,532,000

	20X1	20X0
CFC, 5.75% Notes due March 31, 2013	\$166,000	\$171,000
CFC, 6.95% Notes due July 31, 2018	1,453,000	1,499,000
CFC, 7.00% Notes due September 30, 2009	443,000	457,000
CFC, 6.40% Notes due October 31, 2026	2,437,000	2,515,000
	\$4,499,000	\$4,642,000
Less: Current Maturities	166,000	160,000
	\$4,333,000	\$4,482,000

Unadvanced loan funds of \$286,000 and \$2,500,000 are available to the cooperative on loan commitments from RUS and CFC as of December 31, 20X1. As of December 31, 20X1, annual maturities of long-term debt outstanding for the next five years are as follows:

	RUS	CFC	Total
20X2	\$559,000	\$166,000	\$725,000
20X3	563,000	167,000	730,000
20X4	565,000	167,000	732,000
20X5	568,000	168,000	736,000
20X6	570,000	169,000	739,000

9. Employee Benefits:

Substantially all of the employees of the Association are covered by the ABC Retirement and Security Program, a defined benefit pension plan.

In addition to pension contributions the Association provides health care benefits for substantially all retired employees and dependents until they reach age 65.

The following illustrates the pension and postretirement benefits plans for the year ended December 31, 20X1 and 20X0.

	Pension benefits		Other benefits	
	20X1	20X0	20X1	20X0
Benefit obligation at December 31	\$1,762,000	\$2,080,000	\$1,899,000	\$1,800,000
Fair value of plan assets at December 31	715,000	513,000	0	0
Funded status	\$(1,047,000)	\$(1,567,000)	\$(1,899,000)	\$(1,800,000)
Prepaid (Accrued) benefit cost	\$(243,000)	\$(365,000)	\$(1,004,000)	\$(841,000)
Weighted-average assumptions as of December 31:				
Discount rate	6.75%	5.50%	8.00%	8.00%
Expected return on plan assets	6.50%	6.00%		
Rate of compensation increase	5.00%	5.50%	6.00%	6.00%

For measurement purposes, a 10 percent annual rate of increase in the per capita cost of covered health benefits was assumed for 20X2. The rate was assumed to decrease gradually to 5 percent and remain at that level thereafter.

	Pension benefits		Other benefits	
	20X1	20X0	20X1	20X0
Benefit cost	\$253,000	\$232,000	\$220,000	\$220,000
Employer Contribution	160,000	225,000	57,000	55,000
Benefits Paid	(7,000)	(48,000)	(57,000)	(55,000)

10. Deferred Credits:

Following is a summary of the amounts recorded as deferred credits as of December 31, 20X1 and 20X0:

	20X1	20X0
Customer Energy Prepayments	\$33,000	\$15,000
Inventory Adjustment	26,000	38,000
	\$59,000	\$53,000

11. Litigation:

The association 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 association as a result of this action.

12. Commitments:

Under its wholesale power agreement, the association is committed to purchase its electric power and energy requirements from Fall River Power Cooperative, Inc., until December 31, 20X7. The rates paid for such purchases are subject to review annually.

Exhibit 5—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, 20X2

Board of Directors

Center County Electric Energy Association, Inc.

[City, State]

We have audited the financial statements of Center County Electric Energy Association, Inc. for the year ended December 31, 20X1, and have issued our report thereon dated March 2, 20X2. 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 Center County Electric Energy Association, Inc. for the year ended December 31, 20X1, 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.

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.]

Section 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 § 1773.33(e)(1), related party transactions, depreciation rates, a schedule of deferred debits and credits, and a schedule of investments upon which we express an opinion. In addition, our audit of the financial statements also included the procedures specified in § 1773.38 through 1773.45. 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, 2002 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 § 1773.33 are presented below.

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

We noted no matters regarding Center County Electric Energy Association, Inc.'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

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:

- 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, 20X1:

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 § 1773.33(e)(1)(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 7 or Form 12 to the RUS:

1. Agreed amounts reported in Form 7 or Form 12 to Center County Electric Energy Association, Inc.'s records.

The results of our tests indicate that, with respect to the items tested, Center County Electric Energy Association, Inc. 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 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 § 1773.33(e)(1)(i) [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, 20X1, represented by the borrower as having been submitted to RUS in agreement with the Center County Electric Energy Association, Inc.'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 Center County Electric Energy Association, Inc., nothing came to our attention that caused us to believe that Center County Electric Energy Association, Inc. failed to comply with respect to:

- The reconciliation of continuing property records to the controlling general ledger plant accounts addressed at § 1773.33(c)(1) [list all exceptions];
- The clearing of the construction accounts and the accrual of depreciation on completed construction addressed at § 1773.33(c)(2) [list all exceptions];
- The retirement of plant addressed at § 1773.33(c)(3) and (4) [list all exceptions];
- Approval of the sale, lease, or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap addressed at § 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, 2001, in the financial statements referenced in the first paragraph of this report addressed at § 1773.33(f) [list all exceptions];

- The depreciation rates addressed at § 1773.33(g) [list all exceptions];
- The detailed schedule of deferred debits and deferred credits; and
- The detailed schedule of investments.

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 § 1773.33(h) and the detailed schedule of investments required by § 1773.33(i), and provided below, are presented for purposes of additional analysis and are 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.]

[The detailed schedule of investments would be included here. The total of the investment in each company reported must agree with the detail investment subsidiary account(s).]

This report is intended solely for the information and use of the board of directors, management, and the RUS and supplemental lenders and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Certified Public Accountants

Appendix B to RUS Bulletin 1773-1— Sample Auditor's Report for a Class A or B Commercial Telecommunications Company

Appendix B includes an example of a short-form auditor's report, report on compliance and on internal control over financial reporting, financial statements and accompanying notes for a commercial telecommunications company. The sample auditor's report is intended as a guide only and, while it is recommended that the format be followed, each auditor's report should be prepared to adequately cover the circumstances. To the extent possible, it should be used as a guide in preparing auditors' reports for other types of telecommunications borrowers.

Exhibit 1—Sample Auditor's Report

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

The Board of Directors, Center County Telecommunications Systems, Inc.:
Independent Auditor's Report

We have audited the accompanying balance sheets of Center County Telecommunications Systems, Inc., as of December 31, 20X1 and 20X0, 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 Telecommunications Systems Inc.'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 County Telecommunications Systems, Inc. as of December 31, 20X1 and 20X0, 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, 20X2, on our consideration of Center County Telecommunications Systems, Inc.'s internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

Certified Public Accountants
March 2, 20X2

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 Telecommunications Systems, Inc.:

We have audited the financial statements of Center County Telecommunications Systems, Inc. as of and for the years ended December 31, 20X1 and 20X0, and have issued our report thereon dated March 2, 20X2. 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 Telecommunications Systems, Inc.'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 Telecommunications Systems, Inc. in a separate letter dated March 2, 20X1.]

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Center County Telecommunications Systems, Inc.'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 Telecommunications Systems Inc., in a separate letter dated March 2, 20X2.]

This report is intended solely for the information and use of the audit committee, management, the Rural Utilities Service, and supplemental lenders and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Certified Public Accountants
March 2, 20X2

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 County Telecommunications Systems Inc.

We have audited the financial statements of Center County Telecommunications Systems Inc., as of and for the years ended December 31, 20X1 and 20X0, and have issued our report thereon dated March 2, 20X2. 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 Telecommunications Systems' 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 Telecommunications Systems, Inc. in a separate letter dated March 2, 20X2.]

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Center County Telecommunications Systems, Inc.'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 Telecommunications Systems, Inc.'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 County Telecommunications Systems, Inc., in a separate letter dated March 2, 20X2.]

This report is intended solely for the information and use of the audit committee, management, the Rural Utilities Service, and supplemental lenders and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Certified Public Accountants
March 2, 20X2

Exhibit 4—Sample Financial Statement

CENTER COUNTY TELECOMMUNICATIONS SYSTEMS, INC. BALANCE SHEETS DECEMBER 31, 20X1 AND 20X0 ASSETS

[Notes 1 and 2]

	20X1	20X0
Current Assets:		
Cash—Construction Funds	\$500	\$300
Cash—General Funds	60,000	32,000
Temporary Investments	26,000	24,000
Accounts Receivable, less accumulated provision of \$35,000 in 20X1 and \$34,000 in 20X0.	740,000	667,000
Materials and Supplies	250,000	210,000
Prepayments (Note 3)	50,000	31,700
Other Current Assets	25,000	30,000
Total Current Assets	1,151,500	995,000
Noncurrent Assets:		
Investments (Note 4):		
Marketable Securities	741,500	705,000
Nonregulated	1,550,000	1,450,000
Other deferred charges	39,000	12,000
Total Noncurrent Assets	2,330,500	2,167,000
Property, Plant and Equipment:		
Telecommunications Plant in Service (Note 5)	22,800,000	20,100,000
Telecommunications Plant Under Construction	1,200,000	1,100,000
	24,000,000	21,200,000
Accumulated Provision for Depreciation	8,500,000	7,200,000
Total Property, Plant and Equipment	15,500,000	14,000,000

CENTER COUNTY TELECOMMUNICATIONS SYSTEMS, INC. BALANCE SHEETS DECEMBER 31, 20X1 AND 20X0 ASSETS—
Continued
[Notes 1 and 2]

	20X1	20X0
Total Assets	\$18,982,000	\$17,162,000

The accompanying notes are an integral part of these statements.

CENTER COUNTY TELECOMMUNICATIONS SYSTEMS, INC. BALANCE SHEETS DECEMBER 31, 20X1 AND 20X0 LIABILITIES
AND RETAINED EARNINGS
[Note 2]

	20X1	20X0
Current Liabilities:		
Accounts Payable	\$320,000	\$324,000
Customer Deposits	33,000	30,000
Current portion of long-term debt	579,000	449,000
Accrued Taxes	500	49,800
Other Current Liabilities	22,000	15,000
Total Current Liabilities	954,500	867,800
Long-term debt:		
RUS Mortgage Notes, less current portion (Note 6)	8,900,000	8,100,000
Accrued Postretirement benefits (Note 7)	664,000	503,000
Total Long-term liabilities	9,564,000	8,603,000
Other Liabilities and Deferred Credits:		
Deferred Income Taxes (Note 8)	190,000	176,000
Other	110,000	98,000
Total Other Liabilities and Deferred Credits	300,000	274,000
Stockholder's Equities:		
Capital Stock—Common \$100 par value—5,000 shares authorized; 3,500 outstanding 20X1 and 20X0	350,000	350,000
Additional Paid-in Capital	250,000	250,000
Retained Earnings	7,560,500	6,814,800
Accumulated Other Comprehensive Income (Loss)	3,000	2,400
Total Stockholder's Equities	8,163,500	7,417,200
Total Equities and Liabilities	\$18,982,000	\$17,162,000

The accompanying notes are an integral part of these statements.

CENTER COUNTY TELECOMMUNICATIONS SYSTEMS, INC. STATEMENTS OF INCOME AND RETAINED EARNINGS FOR THE
YEARS ENDED DECEMBER 31, 20X1 AND 20X0

	20X1	20X0
Operating Revenues:		
Local Network Services	\$1,481,000	\$924,000
Network Access Services	3,706,700	3,023,800
Billing and Collection Services	306,000	279,000
Miscellaneous	206,000	139,000
Less: Uncollectible Revenues	(26,000)	(22,000)
Total Operating Revenues	5,673,700	4,343,800
Operating Expenses:		
Plant Specific Operations	976,000	676,000
Plant Nonspecific Operations	222,000	174,000
Depreciation and Amortization	1,341,000	855,000
Customer Operations	737,000	544,000
Corporate Operations	1,034,000	809,000
Other Taxes	26,000	36,000
Total Operating Expenses	4,336,000	3,094,000
Operating Income	1,337,700	1,249,800
Other Income (Expense):		

CENTER COUNTY TELECOMMUNICATIONS SYSTEMS, INC. STATEMENTS OF INCOME AND RETAINED EARNINGS FOR THE
YEARS ENDED DECEMBER 31, 20X1 AND 20X0—Continued

	20X1	20X0
Interest and dividend income	238,000	236,000
Interest expense	(489,000)	(429,000)
Interest during construction	53,000	28,000
Net Other Income and Expenses	(198,000)	(165,000)
Income Before Income Taxes	1,139,700	1,084,800
Income Taxes	126,000	81,000
Net Income Before Nonregulated Income	1,013,700	1,003,800
Nonregulated Income	33,000	27,000
Net Income for the Period	1,046,700	1,030,800
Retained Earnings at Beginning of Year	6,814,800	6,053,000
Dividends Paid	301,000	269,000
Retained Earnings at End of Year	\$7,560,500	\$6,814,800

The accompanying notes are an integral part of these statements.

CENTER COUNTY TELECOMMUNICATIONS SYSTEMS, INC. STATEMENTS OF COMPREHENSIVE INCOME FOR THE YEARS
ENDED DECEMBER 31, 20X1 AND 20X0

	20X1	20X0
Net Income	\$1,046,700	\$1,030,800
Other Comprehensive Income:		
Unrealized holding gains (losses) arising during the year	600	1,500
Comprehensive Income	\$1,047,300	\$1,032,300

The accompanying notes are an integral part of these statements.

CENTER COUNTY TELECOMMUNICATIONS SYSTEMS, INC. STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED
DECEMBER 31, 20X1 AND 20X0

	20X1	20X0
Cash Flows From Operating Activities:		
Cash Received from Consumers	\$5,382,000	\$4,276,000
Cash Paid to Suppliers and Employees	(2,580,400)	(2,026,200)
Interest Received	238,000	236,000
Interest Paid	(489,000)	(429,000)
Taxes Paid	(141,500)	(94,000)
Net Cash Provided by Operating Activities	2,409,100	1,962,800
Cash Flows From Investing Activities:		
Construction and Acquisition of Plant	(2,612,000)	(2,523,000)
Plant Removal Costs	(229,000)	(82,000)
(Increase) Decrease In:		
Materials Inventory	(40,000)	(58,000)
Investments in Marketable Securities	(37,900)	(34,500)
Other Investments	(100,000)	(135,000)
Deferred Charges	(27,000)	23,000
Nonregulated Income	33,000	27,000
Net Cash Used in Investing Activities	(3,012,900)	(2,782,500)
Cash Flows From Financing Activities:		
Dividends Paid	(301,000)	(269,000)
Debt Proceeds	1,379,000	1,158,000
Payments on Long-Term Debt	(449,000)	(444,000)
Increase/(Decrease) In:		
Consumer Deposits and Advance Payments	3,000	13,000
Net Cash Provided by Financing Activities	632,000	458,000
Net Increase/(Decrease) in Cash	28,200	(361,700)
Cash—Beginning of Year	32,300	394,000

CENTER COUNTY TELECOMMUNICATIONS SYSTEMS, INC. STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED
DECEMBER 31, 20X1 AND 20X0—Continued

	20X1	20X0
Cash—End of Year	60,500	32,300

RECONCILIATION OF NET MARGINS TO NET CASH PROVIDED BY OPERATING ACTIVITIES

	20X1	20X0
Net Margins	\$1,046,700	\$1,030,800
Less: Nonregulated Income	33,000	27,000
Net Income from Regulated Operations	1,013,700	1,003,800
Adjustments to Reconcile Net Margins to Net Cash Provided by Operating Activities:		
Depreciation and Amortization	1,341,000	855,000
Provision for Uncollectible Accounts Receivable	1,000	1,000
Accumulated Provision for Pensions and Benefits	161,000	133,000
(Increase)/Decrease In:		
Customer and Other Accounts Receivable	(74,000)	(69,000)
Current and Accrued Assets—Other	5,000	15,000
Prepayments	(18,300)	15,000
Increase/(Decrease) In:		
Accounts Payable	(4,000)	29,000
Accrued Taxes	(49,300)	(13,000)
Other Current and Accrued Liabilities	7,000	(2,000)
Deferred Credits	26,000	(5,000)
Total Adjustments	959,000	1,395,400
Net Cash Provided by Operating Activities	\$2,409,100	\$1,962,800

(The accompanying notes are an integral part of these statements.)

CENTER COUNTY TELECOMMUNICATIONS SYSTEMS, INC. NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 20X1 AND
20X0

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. Prepaid Expenses:

Following is a summary of the amounts recorded as prepaid items as of December 31, 20X1 and 20X0:

	20X1	20X0
Prepaid Taxes	\$10,000	\$10,000
Prepaid Insurance	3,000	1,700
Prepaid Rent	37,000	20,000
	\$50,000	\$31,700

4. Investments:

Marketable Debt and Equity Securities:

Center County Telecommunications System, Inc., has adopted SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities." In accordance with SFAS No. 115, the company has classified all the Other Investments as available-for-sale. Available-for-sale investments are stated at fair value with unrealized gains and losses included in stockholder's equities. The cost of investments sold is based on the specific identification method.

The cost and fair values of marketable securities available-for-sale at December 31, 20X1 and 20X0 were:

Description	20X1			
	Amortized cost	Gross unrealized gain	Gross unrealized loss	Fair value
U.S. Government Treasury securities	\$62,500	\$2,900	\$900	\$64,500
Certificate of Deposit	420,000			420,000
Debt Securities	280,000	6,000	3,000	283,000

Description	20X1			
	Amortized cost	Gross unrealized gain	Gross unrealized loss	Fair value
	\$762,500	\$8,900	\$3,900	\$767,500

Description	20X0			
	Amortized cost	Gross unrealized gain	Gross unrealized loss	Fair value
U.S. Government Treasury securities	\$68,000	\$1,200	\$200	\$69,000
Certificate of Deposit	408,000	.....	.....	408,000
Debt Securities	249,000	5,000	2,000	252,000
	\$725,000	\$6,200	\$2,200	\$729,000

At December 31, 20X1, maturities of investments classified as available-for-sale were as follows:

	Amortized cost	Fair value
Less than One Year	\$25,000	\$26,000
One through Five Years	681,000	684,000
After Five Years	56,500	57,500
Total	\$762,500	\$767,500

As of December 31, 20X1 and 20X0, the amount of unrealized gains on available for sale securities included in accumulated other comprehensive income is shown net of deferred income taxes of \$2,000 and \$1,600, respectively.

Nonregulated Investments:

Investments in nonregulated activities consist of the following:

	20X1	20X0
Customer Premises Equipment	\$493,000	\$500,000
CATV equipment	650,000	678,000
Cellular facilities	1,329,000	1,047,000
Other	28,000	35,000
Total Nonregulated Investments	2,500,000	2,260,000
Less: Accumulated Depreciation	950,000	810,000
	\$1,550,000	\$1,450,000

Nonregulated property is stated at cost. The company provides for depreciation on a straight-line basis at annual rates which will amortize the depreciable property over its estimated useful life.

Following is a summary of net income from nonregulated investments for the year ending December 31, 20X1 and 20X0:

	20X1	20X0
Income	\$400,000	\$268,000
Expenses	367,000	241,000
	\$33,000	\$27,000

Income tax expense related to these activities totaled \$15,000 in 20X1 and \$12,000 in 20X0.

5. Investment in Telecommunications Plant:

Telecommunications Plant in Service and under construction is stated at cost. Listed below are the major classes of the telecommunications plant as of December 31, 20X1 and 20X0:

	20X1	20X0
Land	\$185,000	\$185,000
Buildings	1,385,000	1,435,000
Central Office Equipment	9,929,000	8,379,000
Outside Plant	10,226,000	9,120,000
Furniture and Office Equipment	352,000	256,000
Vehicles and Work Equipment	723,000	725,000
	\$22,800,000	\$20,100,000

The company provides for depreciation on a straight-line basis at annual rates which will amortize the depreciable property over its estimated useful life. Such provision, as a percentage of the average balance of telecommunications plant in service was 7.2 percent in 20X1 and 7.1 percent in 20X0.

6. Mortgage Notes:

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, 20X1 and 20X0:

	20X1	20X0
2% Notes due September 30, 20X8	\$2,495,000	\$2,373,000
5% Notes due March 31, 20X12	6,984,000	6,176,000
	9,479,000	8,549,000
Less: Current Maturities	579,000	449,000
	\$8,900,000	\$8,100,000

As of December 31, 20X1, there were no unadvanced funds.

Principal and interest installments on the above notes are due quarterly in equal amounts of \$254,000. As of December 31, 20X1, annual maturities of long-term debt outstanding for the next five years are as follows:

20X2	\$579,000
20X3	600,000
20X4	612,000
20X5	624,000
20X6	637,000

The long-term debt agreements contain restrictions on the payment of dividends or redemption of capital stock. The terms of the Mortgage Agreement require the maintenance of defined amounts in member's equity and working capital after payment of dividends.

7. Employee Benefits:

Substantially all of the employees of the Company are covered by the ABC Retirement and Security Program, a multiemployer plan.

In addition to pension contributions the Company provides health care benefits for substantially all retired employees and dependents until they reach age 65.

The following illustrates the pension and postretirement benefits plans for the year ended December 31, 20X1 and 20X0.

	Pension benefits		Other benefits	
	20X1	20X0	20X1	20X0
Change in benefit obligation:				
Benefit obligation beginning of year	\$1,871,000	\$1,841,000	\$1,552,000	\$1,464,000
Service Cost	115,000	145,000	39,000	39,000
Interest Cost	95,000	86,000	104,000	104,000
Actuarial Gain	(490,000)	(157,000)		
Benefits Paid	(6,000)	(43,000)	(58,000)	(56,000)
Benefit obligation at end of year	\$1,585,000	\$1,872,000	\$1,637,000	\$1,551,000
Change in plan assets:				
Fair value of plan assets beginning of year	\$461,000	\$281,000	\$0	\$0
Actual return on plan assets	45,000	21,000		
Employer Contribution	144,000	203,000	58,000	56,000
Benefits Paid	(6,000)	(43,000)	(58,000)	(56,000)
Fair value of plan assets at end of year	\$644,000	\$462,000	\$0	\$0
Funded status	\$(941,000)	\$(1,410,000)	\$(1,637,000)	\$(1,551,000)
Unrecognized net actuarial loss (gain)	(97,000)	428,000		
Unrecognized prior service cost	627,000	654,000		
Unrecognized transition obligation			973,000	1,048,000
Prepaid (Accrued) benefit cost	\$(411,000)	\$(328,000)	\$(664,000)	\$(503,000)
Weighted-average assumptions as of December 31:				
Discount rate	6.75%	5.50%	8.00%	8.00%
Expected return on plan assets	6.50%	6.00%		
Rate of compensation increase	5.00%	5.50%	6.00%	6.00%
Components of net periodic benefit cost:				
Service cost	\$115,000	\$145,000	\$39,000	\$39,000
Interest cost	95,000	86,000	104,000	104,000
Expected return on plan assets	(33,000)	(22,000)		
Amortization of prior service cost	27,000	27,000		
Amortization of transition obligation			75,000	75,000
Recognized net actuarial loss	24,000	(28,000)		
Net periodic benefit cost	\$228,000	\$208,000	\$218,000	\$218,000

8. Income Taxes and Deferred Income Taxes:

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amount of the company's assets and liabilities for financial reporting basis and the amounts used for income tax purposes.

Deferred federal and state tax assets and liabilities in the accompanying balance sheet include the following:

	December 31,	
	20X1	20X0
Deferred Tax Liabilities:		
Federal	\$192,000	\$152,000
State	31,000	25,000
Total Deferred Tax Liabilities:	223,000	177,000
Deferred Tax Assets:		
Federal	28,000	700
State	5,000	300
Total Deferred Tax Assets	33,000	1,000
Net Deferred Tax Liability	\$190,000	\$176,000
Current Portion	\$0	\$0
Long-term portion	190,000	176,000
Net Deferred Tax Liability	\$190,000	\$176,000

Income taxes reflected in the Statement of Income and Retained Earnings include:

	December 31,	
	20X1	20X0
Federal income taxes:		
Current tax expense	\$103,000	\$71,000
Deferred tax expense	10,000	5,000
State income taxes:		
Current tax expense	12,000	6,000
Deferred tax expense	1,000	(1,000)
Total income tax expense	\$126,000	\$81,000

9. Commitments:

The company has executed contracts for construction programs for approximately \$1,600,000 at December 31, 20X1. The amount unpaid against these commitments at December 31, 20X1 is \$1,100,000.

Exhibit 5—Illustrative Independent Auditor's Management Letter for Telecommunications Borrowers

RUS requires that CPAs auditing RUS borrowers provide a management letter in accordance with Section 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 Telecommunications Borrowers

March 2, 20X2
 Board of Directors
 Center County Telecommunications Systems, Inc.
 [City, State]

We have audited the financial statements of Center County Telecommunications Systems, Inc. for the year ended December 31, 20X1, and have issued our report thereon dated March 2, 20X2. 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 Center County Telecommunications Systems, Inc. for the year ended December 31, 20X1, 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.

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.]

Section 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 § 1773.33(e)(2), and related party transactions and investments. In addition, our audit of the financial statements also included the procedures specified in § 1773.38 through 1773.45. 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, 20X2 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 § 1773.33 are presented below.

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

We noted no matters regarding Center County Telecommunications Systems, Inc.'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

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:

- Procedures performed with respect to the requirement for a borrower to obtain written approval of the mortgagee to enter into any contract, agreement or lease between the borrower and an affiliate of Center County Telecommunications Systems, Inc. for the year ended December 31, 20X1:

1. Obtained and read a borrower-prepared schedule of new written contracts, agreements or leases entered into during the year between the borrower and an affiliate 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 Center County Telecommunications Systems, Inc.'s records.

The results of our tests indicate that, with respect to the items tested, Center County Telecommunications Systems, Inc. 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 has obtained written approval of the RUS [and other mortgagees] to enter into any contract agreement or lease with an affiliate 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, 20X1, represented by the borrower as having been submitted to RUS in agreement with the Center County Telecommunications Systems, Inc.'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 Center County Telecommunications Systems, Inc., nothing came to our attention that caused us to believe that Center County Telecommunications Systems, Inc. failed to comply with respect to:

- The reconciliation of continuing property records to the controlling general ledger plant accounts addressed at § 1773.33(c)(1) [list all exceptions];
- The clearing of the construction accounts and the accrual of depreciation on completed construction addressed at § 1773.33(c)(2) [list all exceptions];
- The retirement of plant addressed at § 1773.33(c)(3) and (4) [list all exceptions];
- The approval of the sale, lease, or transfer of capital assets and disposition of proceeds for the sale of lease of plant, material, or scrap addressed at § 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, 20X1, in the financial statements referenced in the first paragraph of this report addressed at § 1773.33(f) [list all exceptions]; and
- The detailed schedule of investments.

Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The detailed schedule of investments required by § 1773.33(i) 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 investments would be included here. The total of the investment in each company reported must agree with the detail investment subsidiary account(s).]

This report is intended solely for the information and use of the board of directors, management, and the RUS and supplemental lenders and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Certified Public Accountants

[FR Doc. 01-12127 Filed 5-18-01; 8:45 am]

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DEPARTMENT OF ENERGY

Office of Energy Efficiency and Renewable Energy

10 CFR Part 431

RIN 1904-AB06

Energy Efficiency Program for Commercial and Industrial Equipment: Efficiency Standards for Commercial Heating, Air Conditioning and Water Heating Equipment

AGENCY: Department of Energy (DOE).

ACTION: Final rule; completion of regulatory review.

SUMMARY: On January 12, 2001, DOE published in the **Federal Register** the final rule entitled "Energy Efficiency Program for Commercial and Industrial Equipment: Efficiency Standards for Commercial Heating, Air Conditioning and Water Heating Equipment" (66 FR 3336). In accordance with the memorandum of January 20, 2001, from the Assistant to the President and Chief of Staff, entitled "Regulatory Review Plan," published in the **Federal Register** on January 24, 2001 (66 FR 7702), DOE temporarily delayed for 60 days the effective date of that rule (66 FR 8745, February 2, 2001). DOE has now completed its review of that regulation, and does not intend to initiate any further rulemaking action to modify its provisions.

DATES: The effective date of the rule amending 10 CFR part 431 published at 66 FR 3336, January 12, 2001, and delayed at 66 FR 8745, February 2, 2001, is confirmed as April 13, 2001.

FOR FURTHER INFORMATION CONTACT: Jill Holtzman, Office of General Counsel, (202) 586-3410, jill.holtzman@hq.doe.gov or Lawrence R. Oliver, Office of the General Counsel, (202) 586-9521, lawrence.oliver@hq.doe.gov or Cyrus Nasserri, Office of Energy Efficiency and Renewable Energy, (202) 586-9138, cyrus.nasserri@ee.doe.gov.

Issued in Washington, DC on May 14, 2001.

Spencer Abraham,
Secretary of Energy.

[FR Doc. 01-12686 Filed 5-18-01; 8:45 am]

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