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BY THE COMPTROLLER GENERAL

112052

# Report To The Congress

OF THE UNITED STATES

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## Examination Of The Rural Telephone Bank's Financial Statements For The Fiscal Year Ended September 30, 1979



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

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

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This report summarizes the results of our examination of the financial statements of the Rural Telephone Bank, Department of Agriculture, for the fiscal year ended September 30, 1979.

The financial statements for the year ended September 30, 1978, which are presented for comparative purposes only, were not examined by us. Therefore, we do not express an opinion on the 1978 statements.

We made our examination pursuant to the Government Corporation Control Act (31 U.S.C. 841).

Copies of the report are being sent to the Director, Office of Management and Budget; the Secretaries of Agriculture and the Treasury; and the Governor, Rural Telephone Bank.

*James R. Steals*  
Comptroller General  
of the United States



COMPTROLLER GENERAL'S  
REPORT TO THE CONGRESS

EXAMINATION OF THE RURAL  
TELEPHONE BANK'S FINANCIAL  
STATEMENTS FOR THE FISCAL YEAR  
ENDED SEPTEMBER 30, 1979,  
DEPARTMENT OF AGRICULTURE

D I G E S T

AGC 00271

The Rural Telephone Bank, an agency of the United States, was established in 1971 by an amendment to the Rural Electrification Act of 1936 (7 U.S.C. 901), to provide for financing or refinancing the construction, improvement, expansion, acquisition, and operation of telephone lines, facilities, or systems in rural areas.

In fiscal year 1979 the Rural Telephone Bank loaned \$130 million to rural telephone systems. It has loaned \$1.2 billion since its inception. Amounts borrowed from the U.S. Treasury, interest and principal collected on loans, and proceeds from the sale of stock are the Rural Telephone Bank's primary sources of funds.

GAO is required by the Government Corporation Control Act (31 U.S.C. 841) to examine the financial transactions of the Bank. GAO's last report was issued in May 1977 and discussed financial transactions through September 30, 1976.

OPINION ON FINANCIAL  
STATEMENTS

In GAO's opinion, the Bank's financial statements present fairly its financial position as of September 30, 1979, and the results of its operations and changes in financial position for the period then ended, in conformity with generally accepted accounting principles.

CED-80-77



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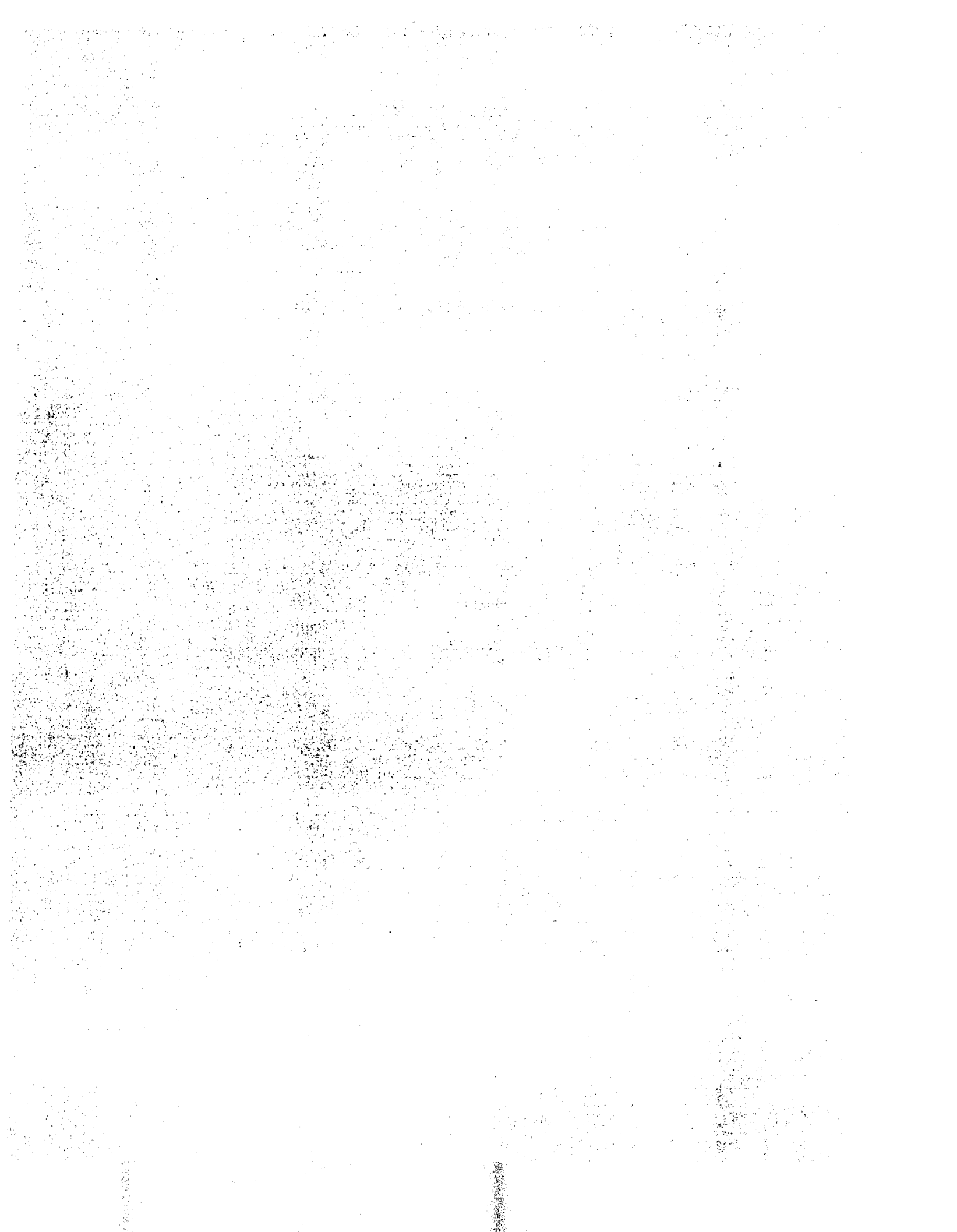
### FINANCIAL STATEMENTS

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### ABBREVIATIONS

GAO	General Accounting Office
REA	Rural Electrification Administration
RTB	Rural Telephone Bank





## CHAPTER 1

### INTRODUCTION

Public Law 92-12 dated May 7, 1971, established the Rural Telephone Bank (RTB) to make loans for the construction, improvement, expansion, acquisition, and operation of telephone lines, facilities, or systems in rural areas. The law amended the Rural Electrification Act of 1936 (7 U.S.C. 901) which, since 1949, has authorized the Administrator of the Rural Electrification Administration (REA), Department of Agriculture, to make loans for essentially the same purposes as the REA telephone program, that is, furnishing and improving telephone service in rural areas. To the extent practicable, RTB is to obtain funds from non-Federal sources and to conduct its operations on a self-sustaining basis.

In fiscal year 1979 RTB loaned \$130 million to rural telephone systems. It has loaned \$1.2 billion since its inception. The amounts borrowed from the U.S. Treasury, interest earned on loans, and proceeds from the sale of stock are RTB's primary sources of funds.

### MANAGEMENT AND ADMINISTRATION

RTB, an agency of the Federal Government, is subject to the direction of the Secretary of Agriculture. The Administrator of the Rural Electrification Administration, who is also the Governor of RTB, is RTB's chief executive officer.

RTB has a 13-member board of directors which is responsible for its management. The Administrator of REA, the Governor of the Farm Credit Administration, five Presidential appointees, and six people elected by RTB's stockholders serve on the board. RTB has no employees; however, the RTB operations are performed by REA employees who also have similar responsibilities for REA operations.

### CAPITALIZATION

RTB issues three classes of capital stock: (1) class A to the Government, (2) class B to RTB borrowers, and (3) class C to RTB borrowers, organizations eligible to borrow, and organizations controlled by borrowers or eligible borrowers.

#### Class A stock

Class A stock has a par value of \$1 a share and is issued, at par, only to the Administrator of REA on behalf

of the United States. The United States provides money for the purchase of class A stock by REA. Public Law 92-12 authorizes the Congress to appropriate up to \$30 million annually for the purchase of class A stock until RTB has issued \$300 million of class A stock. As of September 30, 1979, RTB had \$247,500,000 of class A stock outstanding.

Public Law 92-12 also authorizes RTB to pay the United States a 2-percent annual return on the class A stock outstanding. This return is cumulative and must be paid from RTB's income. In fiscal year 1979 RTB paid \$4.9 million to the U.S. Treasury.

RTB must retire its class A stock as soon as practicable after September 30, 1985, as long as its Board of Directors determines that such retirement will not impair RTB's operations.

#### Class B stock

Class B stock has a par value of \$1 a share. Borrowers must purchase, at par, class B stock equaling 5 percent of the amount borrowed excluding the amounts borrowed to purchase such stock. As of September 30, 1979, RTB had \$56 million of class B stock outstanding. Although class B stockholders do not receive dividends, they receive annual patronage refunds in the form of additional shares of class B stock. RTB's Board of Directors determines the amount of the patronage refund, which is made from net income after deducting the return on class A stock, cash dividends on class C stock, and any addition to the reserve for contingencies. In fiscal year 1979 RTB issued \$3.7 million of class B stock as a patronage refund.

#### Class C stock

Class C stock has a par value of \$1000 a share and is issued at par only to borrowers; to corporations and public bodies eligible to borrow; or to organizations controlled by such borrowers, corporations, and public bodies. As of September 30, 1979, RTB had \$548,000 of class C stock outstanding.

Class C stockholders may be paid dividends from RTB's income if the Board of Directors declares such dividends. The Board can only declare dividends on class C stock when income exceeds the 2-percent return on class A stock. Until all class A stock is retired, the dividend on class C stock cannot exceed the average rate of interest RTB pays to borrow money. In fiscal year 1979 RTB paid \$32,820 in dividends on class C stock.

CONVERSION OF OWNERSHIP, OPERATION,  
AND CONTROL OF THE BANK

When 51 percent of the maximum amount of class A stock issued and outstanding at any time after September 30, 1985, has been retired:

--The powers and authority of the Administrator of REA will be vested in RTB's Board of Directors, and the Board will select a new Governor for RTB.

--The five Board members appointed by the President will no longer be members of the Board.

--RTB will no longer be a U.S. agency.

--RTB will continue as an instrumentality of the United States and a banking corporation.

When all class A stock has been retired, RTB loans will not be subject to restrictions imposed by Public Law 92-12; however, after that time, the Congress can continue to review RTB's operations.

CHAPTER 2

OPERATIONS

BORROWING POWER

Public Law 92-12 authorizes RTB to obtain funds by selling its bonds, debentures, notes, and other evidences of indebtedness (collectively called telephone debentures). RTB's Board of Directors determines when telephone debentures may be issued, their interest rate, and other terms and conditions. The amount of outstanding telephone debentures may not exceed 20 times RTB's paid-in capital and retained earnings.

On June 30, 1972, Public Law 92-324 gave the Secretary of the Treasury the authority to purchase RTB's telephone debentures. The Secretary of the Treasury determines the rate of return that must be realized on any telephone debentures purchased. The current average yield on outstanding marketable U.S. securities with comparable maturity must be considered.

At September 30, 1979, cumulative debenture borrowings from the Secretary of the Treasury amounted to \$394,868,000 at various interest rates, as shown below.

<u>Interest rate</u>	<u>Borrowings from Treasury from inception through September 30, 1979</u>
7.250	\$ 5,071,000
7.375	7,667,000
7.500	10,017,000
7.625	10,461,000
7.750	24,451,000
7.875	29,603,000
8.000	11,092,000
8.125	60,571,000
8.250	48,290,000
8.375	53,989,000
8.500	37,376,000
8.625	9,037,000
8.750	11,647,000
8.875	6,103,000
9.000	52,995,000
9.125	12,097,000
9.250	<u>4,401,000</u>
	<u>\$394,868,000</u>

RTB can repay amounts borrowed from the Treasury through the sale of telephone debentures at any time. Repayments will be applied to the oldest amounts outstanding. No amounts borrowed from the Treasury had been repaid as of September 30, 1979.

The Secretary of the Treasury can sell acquired telephone debentures at any price considered appropriate. All purchases and sales of telephone debentures by the Secretary are treated as public debt transactions of the United States.

#### LENDING POWER

RTB can make loans, in conformity with policies approved by the Board of Directors, to corporations and public bodies which have received an REA loan or loan commitment or have been certified by the Administrator of REA to be eligible for a loan or loan commitment. RTB's loans may be made

--for the same purposes as REA loans made under section 201,

--to finance or refinance the construction, improvement, expansion, acquisition and operation of telephone lines, facilities, or systems in rural areas to improve efficiency, effectiveness or financial stability of borrowers, or

--to finance the purchase of class B stock.

The Rural Electrification Act requires that RTB, rather than REA, loan funds if the borrower is eligible for an RTB loan and RTB has funds available. However, all loans for telephone system facilities which, on the average, will have three or fewer subscribers for each mile of telephone line are to be made by REA unless the borrower elects to take an RTB loan instead.

RTB loans can only be made when, in the judgment of the Governor of RTB, (1) the loan has adequate security and will be repaid within the time agreed and (2) the borrower is able to earn net income before interest which is at least 150 percent of the interest requirements on all of its outstanding and proposed loans or, if this is not true, this requirement should be waived because it prevents emergency restoration of the borrower's system or otherwise results in severe hardship to the borrower.

The Governor of RTB determines the terms and conditions of RTB loans that are not specified by law. The Rural Electrification Act, as amended, requires that the interest rate

on an RTB loan be equal to RTB's average cost of money; however, the interest rate cannot be less than 5 percent per annum. The act also requires that RTB loans be repaid within 50 years.

RTB borrowers may not sell or dispose of property, rights, or franchises acquired under the provisions of the Rural Electrification Act, as amended, without the approval of RTB's chief executive officer until any loans obtained from RTB, including all interest and charges, have been repaid.

#### COST OF OPERATIONS

The interest cost of money borrowed from the Treasury through the sale of telephone debentures in fiscal year 1979 ranged from 8.875 to 9.25 percent a year. The total interest cost for fiscal year 1979 was \$27,930,503.

The Rural Electrification Act authorizes RTB to partially or jointly use the facilities and services of REA or any other agency of the Department of Agriculture without cost, and thus are not shown as expenses on the RTB statement. Costs incurred by REA as it provides facilities and services to RTB are generally for salaries and related benefits, employee travel, and automatic data processing.

### CHAPTER 3

#### SCOPE OF EXAMINATION AND

#### OPINION ON FINANCIAL STATEMENTS

##### SCOPE OF EXAMINATION

We have examined the Statement of Financial Condition as of September 30, 1979, and the Statements of Income, Expenses, and Patronage Capital and Changes in Financial Condition for the fiscal year ended September 30, 1979. Our examination was made in accordance with Comptroller General standards for financial and compliance audits and included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We also reviewed RTB's system of internal control and its compliance with applicable laws, rules, and regulations.

The financial statements for the year ended September 30, 1978, which are presented for comparative purposes only, were not examined by us. Therefore, we do not express an opinion on the 1978 statements.

##### OPINION ON FINANCIAL STATEMENTS

In our opinion, the accompanying financial statements (schedules 1 through 3) present fairly the financial position of the Rural Telephone Bank at September 30, 1979, and its income, expenses, patronage capital, and changes in financial position for the fiscal year then ended, in conformity with generally accepted accounting principles.

RURAL TELEPHONE BANKCOMPARATIVE STATEMENT OF FINANCIAL CONDITIONSEPTEMBER 30, 1979, AND SEPTEMBER 30, 1978ASSETS

	September 30, <u>1979</u>	September 30, <u>1978</u>
CASH:		
With U.S. Treasury and on hand	\$ 123,519	\$ 541
INVESTMENTS: (notes 1B and 2)		
In U.S. Government securities at amortized cost	3,864,380	3,978,864
Accrued interest on securities	<u>48,708</u>	<u>51,408</u>
Total investments	3,913,088	4,030,272
LOANS RECEIVABLE: (notes 1C and 3)		
Loans receivable	739,309,632	614,098,533
Accrued interest on loans	5,634,565	4,084,563
Less: Allowance for possible losses (note 1D)	<u>1,287,000</u>	<u>922,000</u>
Net loans receivable	743,657,197	617,261,096
OTHER PREPAYMENTS AND DEFERRED CHARGES	<u>533</u>	<u>574</u>
Total assets	<u>\$747,694,337</u>	<u>\$621,292,483</u>



LIABILITIES, INVESTMENT, AND EQUITY

	September 30, <u>1979</u>	September 30, <u>1978</u>
LIABILITIES: (note 4)		
Current:		
Accounts payable	\$ 33,896	\$ 8,287
Accrued interest on loans payable to U.S. Treasury	<u>7,835,215</u>	<u>6,232,442</u>
Total current liabilities	7,869,111	6,240,729
Long-term debt:		
Advances from U.S. Treasury (note 5)	<u>394,868,000</u>	<u>319,272,000</u>
Total liabilities	402,737,111	325,512,729
INVESTMENT OF THE U.S. GOVERNMENT:		
Class A stock	247,500,000	217,500,000
EQUITY OF THE PUBLIC:		
Capital stock		
Class B stock -		
Total subscriptions	57,519,978	51,293,678
Less: Unissued	<u>11,780,800</u>	<u>12,003,250</u>
Subscriptions paid	45,739,178	39,290,428
Patronage refund	<u>10,725,645</u>	<u>7,048,375</u>
Total class B stock issued	56,464,823	46,338,803
Class C stock	<u>548,000</u>	<u>547,000</u>
Total capital stock issued	57,012,823	46,885,803
Patronage capital-current (note 1E)	12,760,542	11,212,946
Reserve for contingency (note 1E(1))	<u>27,683,861</u>	<u>20,181,005</u>
Total equity of the public	<u>97,457,226</u>	<u>78,279,754</u>
Total liabilities, investment, and equity	<u>\$747,694,337</u>	<u>\$621,292,483</u>

(The notes on pp. 12 to 14 are an integral part of this statement.)

RURAL TELEPHONE BANKSTATEMENT OF INCOME, EXPENSES, AND PATRONAGE CAPITALFOR THE FISCAL YEARS ENDED SEPTEMBER 30, 1979, AND SEPTEMBER 30, 1978

	<u>Fiscal year ended 9/30/79</u>	<u>Fiscal year ended 9/30/78</u>
INCOME:		
Interest earned on loans	\$45,721,272	\$36,772,716
Interest earned on investments	<u>258,035</u>	<u>265,568</u>
Total income	<u>45,979,307</u>	<u>37,038,284</u>
EXPENSES:		
Operating costs incurred		
Interest expense on funds borrowed from U.S. Treasury	27,930,503	21,212,190
Directors' fees	7,300	13,900
Directors' travel	11,162	14,728
Postage	1,517	995
GAO Audit	27,000	0
Provision for possible losses (note 1D)	365,000	322,000
Miscellaneous	<u>2,438</u>	<u>1,985</u>
Total expenses	<u>28,344,920</u>	<u>21,565,798</u>
NET INCOME FOR THE PERIOD	17,634,387	15,472,486
Less: Provisions for return on class A stock	<u>4,873,845</u>	<u>4,259,540</u>
PATRONAGE CAPITAL FOR THE PERIOD: (note 1E)	<u>12,760,542</u>	<u>11,212,946</u>
PATRONAGE CAPITAL AND RESERVE FOR CON- TINGENCIES-BEGINNING OF THE YEAR	31,393,951	23,161,728
Less: Class C stock cash dividend	32,820	32,760
Patronage refund in form of class B stock (note 1E(2))	<u>3,677,270</u>	<u>2,947,963</u>
RESERVE FOR CONTINGENCIES-END OF YEAR	<u>27,683,861</u>	<u>20,181,005</u>
PATRONAGE CAPITAL AND RESERVE FOR CONTINGENCIES	<u>\$40,444,403</u>	<u>\$31,393,951</u>

(The notes on pp. 12 to 14 are an integral part of this statement.)

## RURAL TELEPHONE BANK

## STATEMENT OF CHANGES IN FINANCIAL POSITION FOR

THE FISCAL YEARS ENDED SEPTEMBER 30, 1979, AND SEPTEMBER 30, 1978

	September 30, 1979	September 30, 1978
FUNDS PROVIDED:		
Income		
Interest earned: Loans	\$ 45,721,272	\$ 36,772,716
Investments	258,035	265,568
Sale of stock: Class A	30,000,000	30,000,000
Class B	6,448,750	8,624,900
Class C	1,000	1,000
Borrowings from U.S. Treasury	75,596,000	85,650,000
Principal collected on loans	5,328,968	4,363,240
Net change in U.S. Government securities at amortized cost	<u>114,485</u>	<u>49,542</u>
	<u>163,468,510</u>	<u>165,726,966</u>
FUNDS APPLIED:		
Operating expenses (less allowance for bad debts)	27,979,920	21,243,798
Advances on loan commitments	130,540,067	142,297,190
Return on class A stock	4,873,845	4,259,540
Dividend on class C stock	<u>32,820</u>	<u>32,760</u>
	<u>163,426,652</u>	<u>167,833,288</u>
INCREASE (DECREASE) IN FINANCIAL POSITION	\$ <u>41,858</u>	\$ <u>(2,106,322)</u>
ANALYSIS OF NET CHANGE IN FINANCIAL POSITION:		
Increase (decrease)-other assets:		
Cash	\$ 122,978	\$ (1,264,359)
Accrued interest on U.S. Government securities	(2,700)	(429)
Accrued interest on loans	1,550,003	808,424
Prepaid and deferred items	<u>(41)</u>	<u>345</u>
	<u>1,670,240</u>	<u>(456,019)</u>
Increase (decrease)-other liabilities		
Accounts payable	25,609	5,804
Accrued interest on loans payable to U.S. Treasury	<u>1,602,773</u>	<u>1,644,499</u>
	<u>1,628,382</u>	<u>1,650,303</u>
NET CHANGE IN FINANCIAL POSITION	\$ <u>41,858</u>	\$ <u>(2,106,322)</u>

(The notes on pp. 12 to 14 are an integral part of this statement.)

RURAL TELEPHONE BANK

NOTES TO FINANCIAL STATEMENTS

SEPTEMBER 30, 1979

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

- A. General - The accounting and reporting policies of the Rural Telephone Bank conform in all material respects with generally accepted accounting principles.
- B. Investments - U.S. Government securities are stated at cost adjusted for amortization of premiums and discounts, both computed by the straight-line method.
- C. Loans receivable - The notes evidencing indebtedness of the Bank's loans are generally for 35 years and are secured by a first mortgage, which also secures equally and ratably notes evidencing indebtedness on REA loans. Interest earned on loans is credited to revenue on an accrual basis based upon the principal amount outstanding.
- D. Allowance for possible losses on loans and interest receivable - The 1969 U.S. Treasury tax formula that commercial banks reporting to the Federal Reserve System are required to use in making provisions for possible loan losses is being used to determine quarterly adjustments to the allowance for possible losses on loans and interest receivable. The allowance for possible losses ratio is adjusted quarterly to 0.006 percent of the loans outstanding at the end of each quarter multiplied by the number of quarters elapsed since June 30, 1972, until a maximum allowance of 0.6 percent of loans and interest receivable has been attained. Quarterly adjustments to increase the ratio of the allowance to outstanding loans and interest receivable are charged to expense.
- E. Patronage capital - Patronage capital consists of net income in excess of the amount necessary to pay a 2-percent per annum return on class A stock into miscellaneous receipts of the U.S. Treasury and any dividends paid to holders of class C stock. Patronage capital is distributed as follows in accordance with the provisions of Section 8.2 Article VIII of RTB's bylaws:

- (1) Reserve for contingency - After the close of each fiscal year not less than 10 percent of the patronage capital, the amount to be determined by the board of directors, shall be placed in a contingency reserve until such time as this reserve shall equal at least 50 percent of the outstanding capital stock. The reserve shall be used to offset and liquidate operating losses and deficits in a systematic manner as determined by the Board of Directors.
- (2) Patronage refunds - The balance of patronage capital shall be distributed to each holder of class B stock as patronage refunds in the form of class B stock as soon as practicable after the close of each fiscal year.

## 2. INVESTMENTS

The market value of U.S. Government securities at September 30, 1979, and September 30, 1978, was \$3,445,060 and \$3,658,732, respectively. Bid price quotations published by the Wall Street Journal and the First National City Bank, New York, N.Y., were used in determining market value. RTB intends to hold these securities, \$739,000 of which will mature during the current fiscal year, to maturity.

## 3. LOANS RECEIVABLE

Loans receivable were as follows:

	September 30, <u>1979</u>	September 30, <u>1978</u>
Cumulative advances on commitments	\$758,881,783	\$628,341,716
Cumulative principal repayments	<u>19,572,151</u>	<u>14,243,183</u>
Loans receivable	<u>\$739,309,632</u>	<u>\$614,098,533</u>

## 4. UNADVANCED LOAN COMMITMENTS

Liabilities do not include the following unadvanced loan commitments:

	September 30, <u>1979</u>	September 30, <u>1978</u>
Cumulative loan commitments	\$1,207,676,173	\$1,076,923,873
Cumulative advances on commitments	<u>758,881,783</u>	<u>628,341,716</u>
Unadvanced on commitments	<u>\$ 448,794,390</u>	<u>\$ 448,582,157</u>

5. LOANS PAYABLE TO U.S. TREASURY

On July 26, 1973, the Governor executed an open end note payable to the Secretary of the Treasury to cover loans to be obtained under section 407 of the Rural Electrification Act, as amended (7 U.S.C. 947). Advances on the note in each fiscal year are to be repaid within 50 years from the June 30th following the date of advance, at the rate of interest established by the Secretary of the Treasury for the calendar month in which each advance is made. Repayments may be made at any time before maturity with application to the oldest advance outstanding. The loans payable to U.S. Treasury by interest rate as of September 30, 1979, and their maturity dates, were as follows:

Amounts borrowed

Interest rate	Total	M A T U R I T Y   D A T E						
		6/30 2024	6/30 2025	6/30 2026	6/30 2027	6/30 2028	6/30 2029	6/30 2030
(millions)								
7.250	\$ 5.1	\$ 5.1	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
7.375	7.7	7.7	0	0	0	0	0	0
7.500	10.0	8.9	0	0	1.1	0	0	0
7.625	10.5	10.5	0	0	0	0	0	0
7.750	24.5	0	0	0	6.7	17.8	0	0
7.875	29.6	9.5	10.7	0	7.3	2.1	0	0
8.000	11.1	0	9.3	1.8	0	0	0	0
8.125	60.6	7.9	15.3	15.6	2.5	19.3	0	0
8.250	48.3	0	10.4	25.2	6.8	5.9	0	0
8.375	54.0	0	23.5	7.6	0	22.9	0	0
8.500	37.4	0	8.2	8.4	0	6.7	14.1	0
8.625	9.0	0	0	.7	0	0	8.3	0
8.750	11.6	0	5.2	0	0	0	6.4	0
8.875	6.1	0	0	0	0	0	6.1	0
9.000	52.9	0	0	0	0	0	9.1	43.8
9.125	12.1	0	0	0	0	0	12.1	0
9.250	4.4	0	0	0	0	0	4.4	0
Total	<u>\$394.9</u>	<u>\$49.6</u>	<u>\$82.6</u>	<u>\$59.3</u>	<u>\$24.4</u>	<u>\$74.7</u>	<u>\$60.5</u>	<u>\$43.8</u>
Weighted Cost	8.31%	7.65%	8.24%	8.27%	7.95%	8.15%	8.83%	9.00%

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