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**DEPARTMENT OF AGRICULTURE
Rural Utilities Service**

Bulletin 1773-1
RD-GD-2018-91

SUBJECT: Policy on Audits of RUS Borrowers and Grantees

TO: RUS Electric and Telecommunications Programs Borrowers and Grantees
Certified Public Accountants

EFFECTIVE DATE: Date of Approval

OFFICE OF PRIMARY INTEREST: Technical Accounting and Auditing Staff, Program Accounting Services Division.

AVAILABILITY: This is a revised bulletin and is available on the RUS website at <https://www.rd.usda.gov/publications/regulations-guidelines/rural-utilities-service-audit>

PURPOSE: This bulletin sets forth, in a more user-friendly format, the codified policies and procedures found in Title 7 CFR Part 1773, RUS Policy on Audits of RUS Borrowers and Grantees. This bulletin also includes sample reports and schedules in Appendices A through D of Part 1773 which are available only in this bulletin


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ACCOUNTING

Policy on Audits

AUDITS

SUBPART A – GENERAL PROVISIONS

§ 1773.1 General.

- (a) This part implements the standards for audits required by the loan and grant agreements of Rural Utilities Service (RUS) electric and telecommunications borrowers and grantees. The provisions require auditees to prepare and furnish to RUS, at least once during each 12-month period, a full and complete report of its financial condition, operations, and cash flows, in form and substance satisfactory to RUS, audited and certified by an independent auditor, satisfactory to RUS, and accompanied by a report of such audit, in form and substance satisfactory to RUS.
- (b) This part is based on the requirements of GAGAS in effect at the time of the audit and applicable RUS regulations and Subpart F (Audit Requirements) of 2 C.F.R. Part 200 (Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards)(2 C.F.R. §§ 200.500 - 200.521).
- (c) This part further sets forth the criteria for selecting auditors satisfactory to RUS and certain audit procedures and audit documentation that must be performed and prepared before an audit report will be accepted by RUS.
- (d) Failure to provide an audit in compliance with this part is a serious violation of the RUS Security Agreement. RUS relies on audited financial statements in order to assess and monitor the financial condition of its borrowers and grantees and to fulfill its fiduciary responsibility.
- (e) RUS reserves the right to suspend its acceptance of audits performed by auditors who, in the opinion of RUS, are not meeting the requirements of this part or with unresolved disputes or issues until such time that the matter can be resolved to RUS' satisfaction.

§ 1773.2 Definitions.

2 CFR Part 200, Subpart F means 2 CFR Part 200, Uniform Administrative Requirements, Cost Principles and Audit Requirements for Federal Awards, Subpart F, Audit Requirements, as adopted by USDA in 2 CFR Part 400.

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

Administrator means the Administrator of RUS.

Affiliated company means a company that directly or indirectly through one or more intermediaries, control or are controlled by, or are under common control with, the auditee.

AICPA means the American Institute of Certified Public Accountants.

ASC means the Accounting Standards Codification issued by the Financial Accounting Standards Board.

Audit means an examination of financial statements by an independent auditor for the purpose of expressing an opinion on the fairness with which those statements present financial position, results of operations, and changes in cash flows in accordance with accounting principles generally accepted in the United States of America (GAAP) and for determining whether the auditee has complied with applicable laws, regulations, and provisions of loan or grant contracts or grant agreements that could have a material effect on the financial statements.

Audit date means the “as of” date established by the auditee.

Audit documentation has the same meaning as defined in the AICPA’s professional auditing standards.

Auditee means an RUS borrower and/or grantee that is required to submit an annual audit as a condition of the award.

Auditor means government auditors as well as certified public accounting firms that perform audits using generally accepted government auditing standards (GAGAS).

BCAS means Broadband Collection and Analysis System (or successor system).

Borrower means an entity that has an outstanding RUS or Federal Financing Bank (FFB) loan or loan guarantee.

CPA means a Certified Public Accountant.

DCS means the Data Collection System (or successor system).

FASB means Financial Accounting Standards Board

FFB means the Federal Financing Bank, a body corporate and instrumentality of the United States of America under the general supervision of the Secretary of the Department of the Treasury.

Fraud has the same meaning as defined in the AICPA’s professional auditing standards.

GAAP has the same meaning as defined in accounting standards issued by the Government Accounting Standards Board (GASB) and the Financial Accounting Standards Board (FASB).

GAGAS means generally accepted government auditing standards as set forth in Government Auditing Standards, issued by the Comptroller General of the United States, Government Accountability Office.

GAO means the United States Government Accountability Office.

GASB means Government Accounting Standards Board

Governance board means the auditee’s board of directors, managing members, or other official body charged with governance.

Grantee means an entity that has a continuing responsibility under a grant agreement with RUS.

Illegal act has the same meaning as define by the Public Company Accounting Oversight Board.

Material weakness has the meaning as defined in the AICPA's professional auditing standards.

OIG means the office of the Inspector General, United States Department of Agriculture

OMB means The Office of Management and Budget.

Regulatory asset means an asset resulting from an action of a regulator as defined by FASB.

Regulatory liability means a liability imposed on a regulated enterprise by an action of a regulator as defined by FASB.

Related party has the same meaning as defined by FASB.

Reporting package means (1) the auditor's report on the financial statements, (2) the report on internal control over financial reporting and on compliance and other matters, (3) the report on compliance with aspects of contractual agreements and regulatory requirements, (4) the schedule of findings and recommendations, and (5) all supplemental schedules and information required by this part.

RUS means the Rural Utilities Service, an Agency of the United States Department of Agriculture.

RUS Bulletin 1773-1, Policy on Audits of RUS Borrowers and Grantees is a publication prepared by RUS that contains the RUS regulation 7 CFR Part 1773 and exhibits of sample audit reports, financial statements, report on internal control over financial reporting and on compliance and other matters, report on compliance with aspects of contractual agreements and regulatory requirements, and schedule of findings and recommendations used in preparing audit of RUS borrowers and grantees. This bulletin is available on the internet at <https://www.rd.usda.gov/publications/regulations-guidelines/rural-utilities-service-audit>.

RUS security agreement means a loan agreement, grant agreement, mortgage, security agreement, or other form of agreement that governs the terms and conditions of, or provides security for, loan and/or grant funds provided by RUS to the auditee.

Significant deficiency has the same meaning as defined in the AICPA's professional auditing standards.

Single Audit Act means Single Audit Act of 1984 (31 U.S.C. 7501 et seq.) as implemented by 2 CFR Part 200, Subpart F.

State means any state or territory of the United States, or the District of Columbia.

Uniform System of Accounts means, for telecommunications borrowers, Bulletin 1770B-1, Accounting Requirements for RUS Telecommunications Borrowers (www.rd.usda.gov/files/UTP_Bulletins_1770B-1.pdf), and for electric borrowers, as contained in 7 CFR Part 1767, Accounting Requirements for RUS Electric Borrowers, subpart B, Uniform System of Accounts.

SUBPART B-RUS AUDIT REQUIREMENTS**§ 1773.3 Annual audit.**

- (a) Each auditee must have its financial statements audited annually by an auditor selected by the auditee and approved by RUS as set forth in §1773.4. All auditees must submit audited financial statements on a comparative basis covering two consecutive 12 month periods, unless the entity has not been in existence for two consecutive 12-month audit periods. Consolidated statements of the parent are not an acceptable replacement for an audit of the auditee.
- (b) Each auditee must establish an annual audit date within 12 months of the date of the first advance and must prepare annual financial statements for the audit date established. Each auditee must notify the AA-PARA of the audit date at least 90 days prior to the selected audit date.
- (c) Auditees must furnish a reporting package to RUS within 120 days of the audit date. (See §1773.21). Until all loans made or guaranteed by RUS are repaid and unliquidated obligations rescinded, auditees that are borrowers must continue to provide annual audited financial statements. Auditees that are grantees must furnish annual audited financial statements in the year of the first advance and until all funds have been advanced or rescinded, and all financial compliance requirements have been fully satisfied.
- (d) In addition to the requirements of this part, certain auditees may be subject to the Single Audit Act. An auditee that is defined as a Non Federal Entity as defined in 2 CFR § 200.69 means a state, local government, Indian tribe, institution of higher education (IHE), or nonprofit organization that carries out a Federal award as a recipient or subrecipient and is required to meet the requirements of Part 1773 as follows:
 - (1) Borrowers and/or grantees expending the threshold established for the Single Audit Act (currently \$750,000) or more in Federal awards during the year must have an audit performed in accordance with the Single Audit Act. See 2 CFR 200.502, Basis for determining Federal awards expended, for guidance in determining annual expenditures. The audited financial statement must be submitted to RUS and to the Federal Audit Clearinghouse.
 - (2) For auditees expending less than the threshold for expenditure in Federal awards during the year, RUS reserves its right under §200.503, Relationship to other audit requirements, to arrange for an audit performed in accordance with Part 1773.
 - (3) Within 30 days of the audit date, auditees must notify the AA-PARA, in writing, of the total Federal awards expended during the year and must state whether the audit will be performed in accordance with the Single Audit Act, or Part 1773.

- (i) An auditee electing to comply with Part 1773 must select an auditor that meets the qualifications set forth in §1773.5.
 - (ii) If an audit is performed in accordance with the Single Audit Act, the auditor's reporting on the financial statements that meet the requirements of the Single Audit Act, will be sufficient to satisfy that auditee's obligations under this part.
- (e) Subpart F of 2 CFR Part 200 does not apply to audits of RUS electric and telecommunications cooperatives and for-profit telecommunications borrowers unless the borrower has contractually agreed with another Federal agency (e.g. Federal Emergency Management Agency) to provide a financial audit performed in accordance with 2 CFR Part 200, Subpart F. In no circumstance will an auditee be required to submit separate audits performed in accordance with this part and 2 CFR Part 200, Subpart F.

§ 1773.4 Auditee's responsibilities.

- (a) Selection of a qualified auditor. The auditee's governance board is responsible for the selection of a qualified auditor that meets the requirements set forth in §1773.5. When selecting an auditor, the auditee should consider, among other matters:
- (1) The qualifications of auditors available to do the work;
 - (2) The auditor's experience in performing audits of utilities, related industries, or in the case of grantees, experience in auditing entities comparable to the grantee; and
 - (3) The auditor's ability to complete the audit and submit the reporting package within 90 days of the audit date.
- (b) Board approval of selection. The board's approval of an auditor must be recorded by a board resolution that states:
- (1) The auditor represents that it meets RUS qualifications to perform an audit; and
 - (2) The auditee and auditor will enter into an audit engagement in accordance with §1773.6.
- (c) Notification of selection. When the initial selection or subsequent change of an auditor has been made, the auditee must notify the AA-PARA, in writing, at least 90 days prior to the audit date.
- (1) Within 30 days of the date of receipt of such notice, RUS will notify the auditee, in writing, if the selection or change in auditor is not satisfactory.
 - (2) Notification to RUS that the same auditor has been selected for succeeding audits of the auditee's financial statements is not required; however, the procedures outlined in this part must be followed for each new auditor selected, even though such auditor may previously have been approved by RUS to audit records of other RUS auditees. Changes in the name of an auditor are considered to be a change in the auditor.

- (d) Audit engagement letter. The auditee must enter into an audit agreement with the auditor that complies with §1773.6 prior to the initiation of the audit.
- (e) Debarment certification. The auditee must obtain, from the selected auditor, a lower tier covered transaction certification (Form AD-1048, Certification Regarding Debarment, Suspension, Ineligibility and Voluntary Exclusion – Lower Tier Covered Transactions), as required by Executive Orders 12549 and 12689, Debarment and Suspension, and any rules or regulations issued thereunder.
- (f) Peer review report. The auditee must obtain, from the selected auditor, a copy of the auditor's current approved peer review report.
- (g) Preparation of schedules. The auditee must prepare any schedules that are required by the auditor to perform the audit, including a schedule of deferred debits and deferred credits and a detailed schedule of investments in subsidiary and affiliated companies accounted for on the cost, equity, or consolidated basis. The detailed schedule of investments can be included in the notes to the financial statements or as a separate schedule as long as all information required is adequately disclosed. Samples of these schedules can be found in Appendices A- D, of RUS Bulletin 1773-1.
 - (1) The schedule of deferred debits and deferred credits must include a description of the deferral and a notation as to whether the deferral has received written approval from RUS. If a determination is made that prior written approval is not required, cite the specific authority for the deferral.
 - (2) The schedule of investments must include investments in subsidiary and affiliated companies, corporations, limited liability corporations and partnerships, joint ventures, etc. accounted for on either the cost, equity or on a consolidated basis. For all investments, the auditee must list the name of the entity, ownership percentage, and the principal business in which the entity is engaged. For investments recorded on the cost basis, the auditee must include the original investment, advances, dividends declared or paid in the current and prior years and the net investment. For investments recorded on the equity or consolidated basis, the auditee must include the ownership percentage, original investment, advances, dividends declared or paid in the current and prior years, and current and prior years' earnings and losses, including accumulated losses in excess of the original investment.
- (h) Scope limitations. The auditee will not limit the scope of the audit to the extent that the auditor is unable to provide an unqualified opinion that the financial statements are presented fairly in conformity with GAAP due to the scope limitation.
- (i) Submission of reporting package. The auditee must submit to RUS the required reporting package as set forth in §1773.21.
 - (1) A reporting package that fails to meet the requirements detailed in this part will be returned to the auditee with a written explanation of noncompliance.

- (2) The auditee must, within 30 days of the date of the letter or email detailing the noncompliance, submit a corrected reporting package to RUS.
 - (3) If a corrected reporting package is not received within 30 days of the date of the letter or email detailing the noncompliance, RUS will take appropriate action, depending on the severity of the noncompliance.
- (j) Submission of a plan of corrective action. If the auditor's report contains findings and recommendations but does not include the auditee's response, the auditee must submit written responses to RUS within 180 days of the audit date. The written responses must address:
- (1) The corrective action already taken or planned, or the reason the auditee believes no action is necessary; and
 - (2) The status of corrective action taken on previously reported findings and recommendations.

§ 1773.5 Qualifications of the auditor.

Auditors that meet the qualifications criteria of this section and enter into an audit engagement with the auditee that complies with §1773.6, will be considered satisfactory to RUS.

- (a) Licensing. Auditors that audit the financial statements of an RUS auditee must be licensed to perform attestation engagements in the United States of America. Auditors do not have to be licensed by the state in which the auditee is located; however, auditors must abide by the rules and regulations of professional conduct promulgated by the accountancy board of the state in which the auditee is located.
- (b) Independence. Auditors must be independent as determined by the standards for independence in the AICPA Code of Professional Conduct and in GAGAS in effect at the time of the audit.
- (c) Peer review requirement. Auditors must be enrolled and participating in a peer review program, and must have undergone a satisfactory peer review of their accounting and audit practice. The peer review must be in effect at the date of the audit report opinion.
 - (1) Peer review reports. RUS reserves the right to request peer review reports from selected auditors.
 - (2) Peer review requirements for new auditors. New auditing firms must meet the requirements of their state board of accountancy with regard to enrolling in a peer review program, timing of the first peer review, and any other peer review requirements.

§ 1773.6 Auditor communication.

- (a) GAGAS and AICPA standards require that the auditor communicate with the auditee the auditor's understanding of the services to be performed and document that understanding through a written communication to those charged with governance. To be acceptable to RUS, the auditor's communication must take the form of an audit engagement letter prepared by the auditor and must be formally accepted by the governance board or an audit committee representing the governance board. In addition to the requirements of the AICPA's professional auditing standards and GAGAS, the engagement letter must also include the following:
- (1) The nature of planned work and level of assurance to be provided related to internal control over financial reporting and compliance with laws, regulation, and provision of contracts or grant agreements.
 - (2) That the auditee and auditor acknowledge that the audit is being performed and that the reporting package is being issued to enable the auditee to comply with the provisions of RUS's security instrument which requires compliance with this part.
 - (3) That the auditor acknowledges the mandatory reporting requirements for fraud, illegal acts, or noncompliance with provisions of laws, regulations, contracts, and grant agreements in §1773.9. Acceptance of the engagement letter by the auditee is required, thus granting the auditor permission to directly notify the appropriate officials which may include but is not limited to the governance board, RUS, and OIG.
 - (4) That the auditor acknowledges that it is required under §1773.7 to contact RUS if the auditor is unable to resolve scope limitations imposed by the auditee, or if such limitations in scope violate this part. Acceptance of the engagement letter by the auditee is required, thus granting the auditor permission to directly notify the AA-PARA as needed.
 - (5) That the auditee and auditor acknowledge that RUS will consider the auditee to be in violation of its RUS Security Agreement and this part if the auditee fails to have an audit performed and documented in compliance with GAGAS and this part.
 - (6) That the auditor represents that it meets the requirements under this part to perform the audit;
 - (7) That the auditor will perform the audit and will prepare the reporting package in accordance with the requirements of this part;
 - (8) That the auditor will document the audit work performed in accordance with GAGAS, and the requirements of this part; and

- (9) That the auditor will make all audit documentation, including the reporting package available to RUS or its representatives (including but not limited to OIG and GAO), upon request, and will permit the photocopying of all such audit documentation.
- (b) A copy of the audit engagement letter must be available at the auditee's office for inspection by RUS personnel. One copy of the current audit engagement letter must be maintained in the auditor's audit documentation.

§ 1773.7 Audit standards.

- (a) The audit of the financial statements must be performed in accordance with GAGAS and this part in effect at the audit date unless the auditee is directed otherwise, in writing, by RUS.
- (b) The audit of the financial statements must include such tests of the accounting records and such other auditing procedures that are sufficient to enable the auditor to express an opinion on the financial statements and to issue the required reporting package.
- (c) Audit scope limitation.
 - (1) The auditee will not limit the scope of the audit to the extent that the auditor is unable to meet RUS audit requirements without prior written approval of the AA-PARA.
 - (2) If the auditor determines during the audit that an unqualified opinion cannot be issued due to a scope limitation imposed by the auditee, the auditor should use professional judgment to determine what levels of the auditee's management and/or those charged with governance should be informed.
 - (3) After informing the auditee's management and/or those charged with governance, if the scope limitation is not adequately resolved, the auditor should immediately contact the AA-PARA.

§ 1773.8 Audit date.

- (a) The annual audit must be performed as of the end of the same calendar month each year unless prior approval to change the audit date is obtained, in writing, from RUS.
 - (1) An auditee may request a change in the audit date by writing to the AA-PARA at least 60 days prior to the currently approved audit date, providing justification for the change.
 - (2) The time period between the prior audit date and the newly requested audit date must be no longer than twenty-three months.
 - (3) Comparative financial statements must be prepared and audited for the 12 months ending as of the new audit date and for the 12 months immediately preceding that period.

§ 1773.9 Disclosure of fraud, and noncompliance with provisions of laws, regulations, contracts, and loan and grant agreements.

- (a) In accordance with GAGAS, the auditor is responsible for planning and performing the audit to provide reasonable assurance about whether the financial statements are free of material misstatement due to error or fraud. The auditor must also plan the audit to provide reasonable assurance of detecting material misstatements resulting from violations of provisions of laws, regulations, contracts or loan or grant agreements that could have a direct and material effect on the financial statements.
- (b) If specific information comes to the auditor's attention that provides evidence concerning the existence of possible violations of provisions of laws, regulations, contracts or loan and grant agreements that could have a material indirect effect on the financial statements, the auditor should apply audit procedures specifically directed to ascertaining whether a violation of provisions of laws, regulations, contract or grant agreements has occurred.
- (c) Pursuant to the terms of its audit engagement letter with the auditee, the auditor must immediately report, in writing, all instances of fraud, illegal acts, and all indications or instances of noncompliance with laws, whether material or not, to:
 - (1) The president of the auditee's governance board;
 - (2) AA-PARA; and
 - (3) OIG, as follows:
 - (i) For all audits performed in accordance with 7 CFR 1773.3(d) (audits conducted in accordance with 2 CFR Part 200 “Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards”), report to the USDA-OIG-Audit, National Single Audit Coordinator for USDA, 401 W Peachtree St, NW, Room 2328, Atlanta, GA 30308,
 - (ii) For all other audits conducted in accordance with 7 CFR 1773.3 report to the appropriate office based on location. See <https://www.usda.gov/oig/national.htm> to determine the correct reporting location.

§ 1773.10 Access to audit documentation.

Pursuant to the terms of this part and the audit engagement letter, the auditor must make all audit documentation available to RUS, or its designated representative, upon request and must permit RUS, or its designated representative, to photocopy all audit documentation.

§§ 1773.11-1773.19 [Reserved]

Subpart C – RUS Requirements for the Submission and Review of the Reporting Package**§ 1773.20 The auditor's submission of the reporting package.**

- (a) Time limit. Within 90 days of the audit date, the auditor must deliver the reporting package to the auditee's governance board. At a minimum, copies should be provided for each member of the governance board and the manager. The auditor must also provide an electronic copy of the audit which meets the requirements of §1773.21 for subsequent transmittal to RUS.
- (b) Communication with the governance board. In addition to providing sufficient copies of the reporting package for each member of the auditee's governance board, RUS requires that the auditor report all audit findings to the auditee's governance board. RUS recommends that audit findings also be communicated orally unless oral communication would not be adequate. If the information is communicated orally, the auditor must document the communication by appropriate memoranda or notations in the audit documentation. If the auditor communicates in writing, a copy of the written communication must be included in the auditor's audit documentation.
- (c) Matters to be communicated. Matters communicated to those charged with governance must include, but are not limited to the matters to be communicated as prescribed in the AICPA's professional standards AU-C Section 260, "The Auditor's Communication with Those Charged with Governance".

§ 1773.21 Auditee's review and submission of the reporting package.

- (a) The auditee's governance board should note and record receipt of the reporting package and any action taken in response to the reporting package in the minutes of the board meeting at which such reporting package is presented.
- (b) The auditee must furnish RUS with an electronic copy of the reporting package within 120 days of the audit date as provided for in §1773.3.
- (c) The auditee must furnish AA-PARA with a copy of its plan for corrective action, if any, within 180 days of the audit date.
- (d) The auditee must include in the reporting package a copy of each special report, summary of recommendations or similar communications, if any, received from the auditor as a result of the audit.
- (e) All required submissions to RUS described in paragraphs (b) through (d) of this section should be furnished electronically. The electronic copy must be provided in a Portable Document Format (PDF). Auditees with a designation from 0001 through 0199 in the Electric program and 500 through 699 in the Telecommunications programs shall upload the reporting package to the DCS or its successor system.

Borrowers and/or grantees with a designation from 1100 through 1199, 1300 through 1399, and 1400 through 1499 in the Broadband program shall upload the reporting package to the BCAS or its successor system. All other borrowers and/or grantees may upload their reporting package through DCS or its successor system. Specific instructions for submission are available from the Technical Accounting and Auditing Staff.

§§ 1773.22-1773.29 [Reserved]

SUBPART D – RUS REPORTING REQUIREMENTS

§ 1773.30 [Reserved]

§ 1773.31 Auditor's report on the financial statements.

The auditor must prepare a written report on comparative balance sheets, statements of revenue and patronage capital (or statement of operations customary to the type of entity reporting) and statements of cash flows. The report must include the manual or printed signature of the auditor, cover all statements presented, and refer to the separate report on internal controls over financial reporting and on compliance and other matters and the report on compliance with aspects of contractual agreements and regulatory requirements issued in conjunction with the auditor's report on the financial statements. The auditor's report on the financial statements should also state that the report on internal controls over financial reporting and on compliance and other matters is an integral part of a GAGAS audit, and in considering the results of the audit, that this report should be read along with the auditor's report on the financial statements.

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

- (a) As required by GAGAS, the auditor must prepare a written report describing the scope of the auditor's testing of internal control over financial reporting and of compliance with provisions of laws, regulations, contracts, and loan and grant agreements, and that the tests provided sufficient, appropriate evidence to support opinions on the effectiveness of internal control and on compliance with provisions of laws, regulations, contracts, and loan and grant agreements. This report must include the manual or printed signature of the auditor and must include the following items as appropriate:
- (1) Significant deficiencies and material weaknesses in internal control;
 - (2) Instances of fraud and noncompliance with provisions of laws or regulations that have a material effect on the audit and any other instances that warrant the attention of those charged with governance;
 - (3) Noncompliance with provisions of contracts or grant agreements that have a material effect on the audit; and
 - (4) Abuse that has a material effect on the audit.

- (b) When the auditor detects instances of noncompliance or abuse that have an effect on the financial statements that are less than material but warrant the attention of those charged with governance, they should communicate those findings in writing to those charged with governance in a separate communication. If the auditor has issued a separate communication detailing immaterial instances of noncompliance or abuse, the report on internal controls over financial reporting and on compliance and other matters must be modified to include a statement such as:

“We noted certain immaterial instances of noncompliance [and/or abuse], which we have reported to the management of (auditee's name) in a separate letter dated (month, day, 20XX).”

- (c) If the auditor has issued a separate letter to management to communicate other matters involving the design and operation of the internal control over financial reporting, the report on internal controls over financial reporting and on compliance and other matters must be modified to include a statement such as:

“However, we noted other matters involving the internal control over financial reporting that we have reported to the management of (auditee's name) in a separate letter dated (month, day, 20XX).”

- (d) The report must contain the status of known but uncorrected deficiencies from prior audits that affect the current audit objective.

§ 1773.33 Report on compliance with aspects of contractual agreements and regulatory requirements.

The auditor must prepare a report on compliance with aspects of contractual agreements and regulatory requirements that includes, at a minimum, comments on:

- (a) Audit procedures. State whether the audit has been performed in accordance with this part;
- (b) Special reports. State whether any special reports, summaries of recommendations, or similar communications were furnished to the auditee's management during the course of the audit or during interim audit work, and provide a description of the information furnished;
- (c) Accounting and records. Comment on whether, during the course of the audit, anything came to the auditor's attention to indicate that the auditee did not maintain adequate and effective accounting procedures and records and utilize adequate and fair methods for accumulating and recording labor, material, and overhead costs, and for distributing these costs to construction, retirement, and maintenance or other expense accounts. Where appropriate, comment on whether anything came to the auditor's attention to indicate that the auditee did not:

- (1) Establish continuing property records (CPRs) that are updated on a current basis, at least annually, and are reconciled with the controlling general ledger plant accounts;
 - (2) Promptly clear construction clearing accounts of costs of completed construction to the proper classified plant accounts and accrue depreciation on such completed construction from the date the plant was placed in service;
 - (3) Currently and systematically record and properly price retirements of plant;
 - (4) Properly account for the accumulated provision for depreciation accounts associated with retirements of plant or properly disclose any unusual charges or credits to such accounts; and
 - (5) Obtain RUS approval for the sale, lease or transfer of capital assets secured under the RUS security agreement when approval is required, and properly handle any proceeds from the sale or lease of plant, material or scrap in conformance with RUS requirements.
- (d) Materials control. Comment on whether, during the course of the audit, anything came to the auditor's attention to indicate that the control over materials and supplies was not adequate.
- (e) Compliance with RUS loan and security instrument provisions. Comment on whether, during the course of the audit, anything came to the auditor's attention to indicate that the following provisions of RUS' loan and security instruments have not been complied with:
- (1) For electric auditees, provisions related to:
 - (i) The requirements for an auditee to obtain written approval of mortgagees to enter into any contract for the management, operation, or maintenance of the auditee's system if the contract covers all or substantially all of the electric system. For purposes of this part, the following contracts shall be deemed as requiring RUS approval:
 - (A) Management contracts in which the auditee has contracted to have another auditee or other entity manage its affairs;
 - (B) Operations and maintenance contracts in which the auditee has contracted to have another auditee or other entity operate and/or maintain all or substantially all of the physical plant facilities of the auditee.
 - (C) Operations and maintenance contracts in which the auditee has contracted to operate and maintain the physical plant facilities of another auditee or other utility system;
 - (ii) The requirement for an auditee to prepare and furnish mortgagees annual or periodic financial and operating reports on the auditee's financial condition and operations accurately and within the required deadlines. The auditor shall comment on whether, during the course of the audit, anything came to the auditor's attention to indicate that the information represented by the auditee as having been submitted to RUS in its most recent December 31 Financial and Operating Report Electric Distribution or Financial and Operating Report Electric

Power Supply was not in agreement with the auditee's audited records. If the auditee represents that an amended report has been filed as of December 31, the comments must relate to the amended report; and

- (iii) The requirement for an auditee to use depreciation rates that are within the ranges established by RUS for each primary plant account (See RUS Bulletin 183-1, Depreciation Rates and Procedures at https://www.rd.usda.gov/files/UPA_Bulletin_183-1.pdf) or with the requirements of the state regulatory body having jurisdiction over the auditee's depreciation rates in computing monthly accruals.
- (2) For telecommunications auditees, provisions related to:
- (i) The requirement for an auditee to obtain written approval of the mortgagees to enter into any contract, agreement or lease between the auditee and an affiliate other than as allowed under 7 CFR Part 1744, subpart E; and
 - (ii) The requirement for an auditee to prepare and furnish mortgagees annual or periodic financial and operating reports on the auditee's financial condition and operations accurately and within the required deadlines. The auditor shall comment on whether, during the course of the audit, anything came to the auditor's attention to indicate that the information represented by the auditee as having been submitted to RUS in its most recent December 31 Operating Report for Telecommunications Borrowers was not in agreement with the borrower's audited records. If the auditee represents that an amended report has been filed as of December 31, the comments must be related to the amended report.
- (3) For Broadband auditees, provisions relating to:
- (i) The requirement for an auditee to prepare and furnish mortgagee quarterly or periodic financial and operating reports on the auditee's financial condition and operations accurately and within the required deadlines. The auditor shall comment on whether, during the course of the audit, anything came to the auditor's attention to indicate that the information represented by the auditee as having been submitted to RUS in its most recent BCAS filing was not in agreement with the auditee's audited records. If the auditee represents that an amended report has been filed, the comments must be related to the amended report.
- (4) For grantees, provisions related to:
- (i) Recipients of Broadband Initiatives Program loans and grants, the requirement for the recipient to prepare and furnish RUS quarterly and annual financial and operating reports on the financial condition and operations of the auditee accurately and within the required deadlines. The auditor shall comment on whether, during the course of the audit, anything came to the auditor's attention to indicate that the information represented by the auditee as having been submitted to RUS in its most recent BCAS filing was not in agreement with the audited records of the auditee. If the auditee represents that an amended report has been filed, the comments must relate to the amended report. The auditor must state whether the Annual Compliance Certificate required by the RUS security agreement has been filed in a timely manner with RUS.

- (ii) Recipients of all other grant programs within the electric and telecommunications programs, the requirements to prepare and furnish RUS with any required financial reporting accurately and within required deadlines, as appropriate for that specific program. The auditor shall comment on whether, during the course of the audit, anything came to the auditor's attention to indicate that the information represented by the grantee as having been submitted to RUS in its most recent filing was not in agreement with the audited records of the grantee. If the grantee represents that an amended report has been filed, the comments must relate to the amended report.
- (f) Related party transactions. Comment on whether, during the course of the audit, anything came to the attention of the auditor to indicate that all material related party transactions have not been disclosed in the notes to the financial statements in accordance with ASC 850, entitled "Related Party Disclosures".
- (g) Deferred debits and deferred credits. For electric auditees, comment on whether, during the course of the audit anything came to the attention of the auditor to indicate that the auditee provided detailed schedule of deferred debits and deferred credits, including, but not limited to, margin stabilization plans, revenue deferral plans, and expense deferrals is not accurately presented. This schedule must be included as supplemental information or within the notes to the financial statement; and
- (h) Investments. For electric and telecommunications auditees, comment on whether, during the course of the audit, anything came to the auditor's attention to indicate that the auditee provided detailed schedule of investments is not accurately presented. This schedule must be included as supplemental information or within the notes to the financial statement. The auditor must state that the audit did not disclose any investments in subsidiary or affiliated companies.

§ 1773.34 Schedule of findings and recommendations.

The auditor must prepare a schedule of findings and recommendations to be included with the audited financial statements. The schedule of findings and recommendations shall be developed and presented utilizing the elements of a finding discussed in GAGAS and shall include recommendations for remediation. If the schedule does not include responses from management, as well as any planned corrective actions, those items must be submitted directly to the AA-PARA by management in accordance with §1773.4 (j).

§§ 1773.35-1773.37 [Reserved]**Subpart E-RUS Audit Requirements and Documentation****§ 1773.38 Scope of engagement.**

The audit requirements set forth in §1773.39 through 1773.45 of this part must be met annually by the auditor during the audit of the RUS auditee's financial statement. The auditor must exercise professional judgement in determining whether any auditing procedures in addition to those mandated by GAGAS or this part should be performed on the auditee's financial records in order to afford a reasonable basis for rendering the auditor's report on the financial statements, report on internal controls over financial reporting and on compliance and other matters, report on compliance with aspects of contractual agreements and regulatory requirements, and schedule of findings and recommendations.

§ 1773.39 Utility plant and accumulated depreciation.

- (a) General. The audit of these accounts shall include tests of additions, replacements, retirements, and changes. The auditor's audit documentation shall support that the auditor:
- (1) Examined direct labor and material transactions to determine whether the auditee's accounting records reflect a complete accumulation of costs;
 - (2) Examined indirect costs and overhead charges to determine if they conform to the Uniform System of Accounts or the Federal Acquisitions Regulations as required under the RUS Security Agreement;
 - (3) Reviewed the costs of completed construction and retirement projects to determine if they were cleared promptly from the work in progress accounts to the classified plant in service accounts and the related depreciation accounts;
 - (4) Examined direct purchases of special equipment and general plant;
 - (5) Determined the degree of accuracy and control of costing retirements, including tests of salvage and removal costs;
 - (6) Reviewed the auditee's work order procedures; and

- (7) Reviewed depreciation rates for adequate support, and compared them to RUS guidelines to determine that they were in compliance.
- (b) Construction work in progress.
- (1) The audit documentation shall include a summary of open work orders reconciled to the general ledger and note on the summary any unusual or atypical projects.
 - (2) The auditor's audit documentation shall support that the auditor:
 - (i) Reviewed equipment purchases charged to work orders, including payments and receiving reports;
 - (ii) Reviewed contracts showing the scope of the work, the nature of the contract, the contract amount, and scheduled payments and reviewed supporting documents to determine that services contracted for were in fact rendered;
 - (iii) Reviewed time cards and pay rates for a sample of employees who allocate their time to work orders;
 - (iv) Reviewed the nature of material and supplies issued to the project, traced amounts and quantities to supporting documents, and reviewed the reasonableness of clearing rates for assignment of stores expense to the work order;
 - (v) Reviewed the accuracy of the computation of overheads applied to the work order; and
 - (vi) Reviewed other costs charged to the work order for support and propriety.
 - (3) The auditor's audit documentation shall support that the auditor:
 - (i) Scheduled payments to contractors and traced to verify payments and supporting invoices;
 - (ii) Traced contract costs to final closeout documents, to the general ledger, and to the continuing property records; and
 - (iii) Verified the costs of owner furnished materials, if applicable.
 - (4) The auditor shall review the auditee's procedures for unitization and classification of work order and contract costs. The auditor's audit documentation shall support that the auditor:
 - (i) Reviewed the tabulation of record units for construction from the work order staking sheets to the tabulation of record units, to the unitization sheets, and to the continuing property records;

- (ii) Reviewed the procedures for unitizing and distributing costs of completed construction to the plant accounts;
 - (iii) Verified that standard costs were being used;
 - (iv) Evaluated the basis for development of standard costs; and
 - (v) Determined that costs of completed construction were cleared promptly from work in progress accounts.
- (c) Continuing property records. The auditor's audit documentation shall support that the auditor:
- (1) Determined whether the subsidiary plant records agree with the controlling general ledger plant accounts;
 - (2) Noted differences in the audit documentation; and
 - (3) Commented, in the report on compliance with aspects of contractual agreements and regulatory requirements, on any discrepancies.
- (d) Retirement work-in-progress. The auditor's audit documentation shall support that the auditor:
- (1) Determined that plant retirements are currently and systematically recorded and priced on the basis of the continuing property records, and determined that costs of removal have been properly accounted for;
 - (2) Explained the method used in computing the cost of units of plant retired if continuing property records have not been established and determined whether costs appeared reasonable; and
 - (3) Determined the manner in which net losses due to retirements were accounted for and traced clearing entries to the depreciation reserve, the plant accounts, and the continuing property records.
- (e) Provision for accumulated depreciation. The auditor's audit documentation shall support that the auditor:
- (1) Verified the depreciation accruals for the period, including the depreciation base;
 - (2) Reviewed the basis of the depreciation rates, any change in rates and the reason for the change, and, if appropriate, determined whether the rates are in compliance with RUS requirements or with the requirements of the state regulatory body having jurisdiction over the auditee's depreciation rates;
 - (3) Reviewed salvage and removal costs; and

- (4) Searched for unrecorded retirements.

- (f) Other reserves. The auditor's audit documentation shall include an account analysis for all other material plant reserves, such as the reserve for the amortization of plant acquisition adjustments. The auditor's audit documentation shall support that appropriate tests of transactions were performed.

- (g) Narrative. The auditor shall include in the audit documentation a comprehensive narrative on the scope of work performed, observations made, and conclusions reached. Matters covered in this narrative shall include:
 - (1) The nature of construction and other additions;
 - (2) The control over, and the accuracy of pricing retirements;
 - (3) The accuracy of distributing costs to classified utility plant accounts;
 - (4) An evaluation of the method of:
 - (i) Capitalizing the direct loadings on labor and material costs;
 - (ii) Distributing transportation costs and other expense clearing accounts; and
 - (iii) Capitalizing overhead costs;
 - (5) The tests of depreciation;
 - (6) A review of agreements such as those relating to acquisitions, property sales, and leases which affect the plant accounts; and
 - (7) Notations, if applicable, of RUS approval of property sales and the propriety of the disposition of the proceeds.

§ 1773.40 Regulatory assets.

The auditor's audit documentation shall support that the auditor tested whether all regulatory assets comply with the requirements of ASC 980. For Electric auditees only, the auditor's audit documentation shall support that all regulatory assets have received RUS approval.

§ 1773.41 Extraordinary retirement losses.

The auditor's audit documentation shall support that the auditor tested retirement losses, including any required approval by a regulatory commission with jurisdiction in the matter, or RUS, in the absence of commission jurisdiction.

§ 1773.42 Clearing accounts.

The auditor's audit documentation shall support that the auditor tested all clearing accounts and that transactions selected for testing were reviewed for proper allocation between expense and capital accounts.

§ 1773.43 Capital and equity accounts.

- (a) Capital stock. For privately owned companies, the audit documentation shall include analyses of all stock transactions during the audit period. The auditor's audit documentation shall support that the auditor:
- (1) Reviewed the subsidiary records and reconciled them to the general ledger control account;
 - (2) Reviewed authorizations and issuances or redemptions of capital stock for proper approvals by the governance board, stockholders, regulatory commissions and RUS, as required;
 - (3) Determined that transactions were made in accordance with the appropriate provisions of the articles of incorporation, bylaws, and RUS loan documents; and
 - (4) Determined that transactions were recorded in accordance with the Uniform System of Accounts.
- (b) Memberships. For cooperative organizations, the audit documentation shall include an analysis of the membership transactions during the audit period. The auditor's audit documentation shall support that the auditor:
- (1) Reviewed the subsidiary records and reconciled them to the general ledger control account; and
 - (2) Determined that transactions were made in accordance with the appropriate provisions of the articles of incorporation, bylaws, and RUS loan documents.
- (c) Patronage capital, retained earnings, margins, and other equities. The audit documentation shall include an analysis of the patronage capital, retained earnings, margins and other equities, and any related reserve accounts. The auditor's audit documentation shall support that the auditor:
- (1) Determined that the transactions were made in accordance with the appropriate provisions of the articles of incorporation, bylaws, RUS loan documents, Uniform System of Accounts, or orders of regulatory commissions;
 - (2) Traced payments to underlying support; and

- (3) Determined whether, under the terms of the RUS security instrument, restrictions of retained earnings or margins are required and, if so, whether they have been properly recorded.

§ 1773.44 Long-term debt.

The auditor's audit documentation shall support that the auditor:

- (a) Confirmed RUS, FFB, and RTB debt to the appropriate confirmation schedule (RUS Form 690, Confirmation Schedule Obligation to the FFB; Form 614, Confirmation Schedule-- Long-term Obligation to RUS; or, Confirmation Schedule for RTB Debt);
- (b) Confirmed other long-term debt directly with the lender;
- (c) Examined notes executed or cancelled during the audit period; and
- (d) Tested accrued interest computations.

§ 1773.45 Regulatory liabilities.

The auditor's audit documentation shall support that all regulatory liabilities comply with the requirements of ASC 980. For electric auditees only, the auditor's audit documentation shall document whether all regulatory liabilities have received RUS approval.

§§ 1773.46-1773.48 [Reserved]

§ 1773.49 OMB Control Number.

The information collection requirements in this part are approved by the Office of Management and Budget (OMB) and assigned the OMB Control Number 0572-0095.

ILLUSTRATIVE REPORTS FOR AN ELECTRIC COOPERATIVE

Appendix A includes an example of an auditor's report, report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with Government Auditing Standards, financial statements and accompanying notes, report on compliance with aspects of contractual agreements and regulatory requirements, and schedule of findings and recommendations 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 - Illustrative Auditor's Report

The Board of Directors
Center County Electric Energy Association, Inc.

Independent Auditor's Report

Report on the Financial Statements

We have audited the accompanying financial statements of Center County Electric Energy Association, Inc., (the "Company") which comprise the balance sheets as of December 31, 20X3 and 20X2, and the related statements of revenue and patronage capital, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 20X3 and 20X2, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

[This section is used for discussing supplementary or other information.]

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 2, 20X4, on our consideration of the Company's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Company's internal control over financial reporting and compliance.

Certified Public Accountants
City, State
March 2, 20X4

EXHIBIT 2 - Illustrative Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*
(No Material Weaknesses Identified, No Significant Deficiencies Identified, No Reportable Instances of Noncompliance or Other Matters Identified)

The Board of Directors
Center County Electric Energy Association, Inc.

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of Center County Electric Energy Association, Inc. (the “Company”) as of and for the years ended December 31, 20X3 and 20X2, and the related notes to the financial statements, which collectively comprise the Company’s basic financial statements, and have issued our report thereon dated March 2, 20X4.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Company's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control.

Accordingly, we do not express an opinion on the effectiveness of the Company’s internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Company's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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 or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Certified Public Accountants
City, State
March 2, 20X4

EXHIBIT 3 - Illustrative Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*
(No Material Weaknesses Identified; Significant Deficiencies Identified; and Reportable Instances of Noncompliance and Other Matters Identified)

The Board of Directors
Center County Electric Energy Association, Inc.

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of Center County Electric Energy Association, Inc. (the “Company”) as of and for the years ended December 31, 20X3 and 20X2, and the related notes to the financial statements, which collectively comprise the Company’s basic financial statements, and have issued our report thereon dated March 2, 20X4.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Company’s internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control.

Accordingly, we do not express an opinion on the effectiveness of the Company’s internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses.

However, material weaknesses may exist

that have not been identified. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings and recommendations that we consider to be significant deficiencies. *[List the reference numbers of the related findings]*.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Company's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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 or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and recommendations as items *[list the reference numbers of the related findings]*

Center County Electric Energy Association, Inc.'s Response to Findings

The Company's responses to the findings identified in our audit are described in the accompanying schedule of findings and recommendations. The Company's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with Governments Auditing Standards in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Certified Public Accountants
City, State
March 2, 20X4

EXHIBIT 4 – Illustrative Financial Statements

**CENTER COUNTY ELECTRIC ENERGY ASSOCIATION
BALANCE SHEETS
DECEMBER 31, 20X3 and 20X2
ASSETS**

| | 20X3 | 20X2 |
|--|--------------|--------------|
| Utility Plant | | |
| 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 | | |
| 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..... | 8,000 | 8,000 |
| Accounts Receivable, less allowance for doubtful..... accounts of \$11,000 in 20X3 and \$10,000 in 20X2..... | 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 | 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
BALANCE SHEETS
DECEMBER 31, 20X3 and 20X2
EQUITIES AND LIABILITIES

| | 20X3 | 20X2 |
|---|---------------------|---------------------|
| Equities | | |
| Memberships..... | \$ 60,000 | \$ 59,000 |
| Patronage Capital | 16,683,000 | 15,343,000 |
| Other Equities | 268,000 | 180,000 |
| Net Unrealized Gain on Investments..... | 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 |
| Pension 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.

**STATEMENTS OF REVENUE AND PATRONAGE CAPITAL
FOR THE YEARS ENDED DECEMBER 31, 20X3 and 20X2**

| | 20X3 | 20X2 |
|--|---------------------|---------------------|
| 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
 STATEMENTS OF COMPREHENSIVE INCOME
 FOR THE YEARS ENDED DECEMBER 31, 20X3 and 20X2**

| | 20X3 | 20X2 |
|--|-------------|-------------|
| 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
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 20X3 and 20X2**

| | 20X3 | 20X2 |
|---|--------------|--------------|
| 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 |

The accompanying notes are an integral part of these statements.

| RECONCILIATION OF NET MARGINS TO NET CASH PROVIDED BY OPERATING ACTIVITIES | 20X3 | 20X2 |
|--|-------------|-------------|
| 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 |
| 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 NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 20X3 AND 20X2**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

[Include a brief description of the reporting entity’s significant accounting policies in accordance with ASC 235, Notes to Financial Statements.

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, 20X3 and 20X2:

| | 20X3 | 20X2 |
|------------------------------------|--------------|--------------|
| 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 20X3 and 20X2:

| | 20X3 | 20X2 |
|---|---------------------|---------------------|
| 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 Association records investments in accordance with the provisions of ASC 320, Investments – Debt and Equity Securities. In accordance with the criteria provided in ASC 320, 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, 20X3 and 20X2:

| Description | 20X3 | | | 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 |
| Other debt securities | 431,000 | 3,000 | 3,000 | 431,000 |
| | \$1,033,000 | \$23,000 | \$8,000 | \$1,048,000 |

| <u>Description</u> | 20X2 | | | |
|--|----------------|-----------------------|-----------------------|-------------|
| | 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, 20X3, 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, 20X3 and 20X2:

| | 20X3 | 20X2 | RUS Approval |
|---|----------|----------|-----------------|
| Preliminary Surveys and Investigations. | \$28,000 | \$ 9,000 | \$1767.13(d)(1) |

6. PATRONAGE CAPITAL

At December 31, 20X3 and 20X2, patronage capital consisted of:

| | 20X3 | 20X2 |
|---------------------------------|--------------|--------------|
| 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 20X3.

7. OTHER EQUITIES:

At December 31, 20X3 and 20X2, other equities consisted of:

| | 20X3 | 20X2 |
|---|------------|------------|
| Retired Capital Credits-Gain..... Donated | \$ 181,000 | \$ 175,000 |
| 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, 20X3 and 20X2:

| | 20X3 | 20X2 |
|---|--------------|--------------|
| RUS, 2% Notes due March 31, 20X7 | \$ 544,000 | \$ 562,000 |
| RUS, 5% Notes due December 31, 20X5 | 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 |

| | 20X3 | 20X2 |
|--|-------------|-------------|
| CFC, 5.75% Notes due March 31, 20X5 | \$ 166,000 | \$ 171,000 |
| CFC, 6.95% Notes due July 31, 20X8..... | 1,453,000 | 1,499,000 |
| CFC, 7.00% Notes due September 30, 20X9..... | 443,000 | 457,000 |
| CFC, 6.40% Notes due October 31, 20X6 | 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, 20X3. As of December 31, 20X3, annual maturities of long-term debt outstanding for the next five years are as follows:

| | RUS | CFC | TOTAL |
|-----------|-----------|-----------|-----------|
| 20X4..... | \$559,000 | \$166,000 | \$725,000 |
| 20X5..... | 563,000 | 167,000 | 730,000 |
| 20X6..... | 565,000 | 167,000 | 732,000 |
| 20X7..... | 568,000 | 168,000 | 736,000 |
| 20X8..... | 570,000 | 169,000 | 739,000 |

9. PENSION PLAN (DEFINED BENEFITS):

Pension benefits for substantially all employees of the Company are provided through participation in the NRECA Retirement Security Plan (RS Plan), a defined benefit plan qualified under Section 401 and tax-exempt under 501(a) of the Internal Revenue Code. The plan sponsor’s employer identification number is 55-5555555 and the plan number is 555.

A unique characteristic of a multiemployer plan compared to a single employer plan is that all plan assets are available to pay benefits of any plan participant. Separate asset accounts are not maintained for participating employers. This means that assets contributed by one employer may be used to provide benefits to employees of another participating employer.

In the RS Plan, a “zone status” determination is not required, and therefore not determined, under the Pension Protection Act (PPA) of 2006. In addition, the accumulated benefit obligations and plan assets are not determined or allocated separately by individual employer. In total, the RS Plan was greater than 80 percent funded at January 1, 20X4 and 20X3 based on the PPA funding target and PPA actuarial value of assets on those dates.

Because the provisions of the PPA do not apply to the RS Plan, funding improvement plans and surcharges are not applicable. Future contribution requirements are determined each year as a part of the actuarial valuation of the plan and may change as a result of plan experience. The Company’s annual contribution to the program represented less than 5 percent of total contribution made to the plan by all participating employers and are equal to the amounts recorded for pension cost. Contributions were \$160,000 and \$225,000 for the years ended December 31, 20X3 and 20X2, respectively.

10. DEFERRED CREDITS:

Following is a summary of the amounts recorded as deferred credits as of December 31, 20X3 and 20X2:

| | 20X3 | 20X2 |
|-----------------------------|-----------|-----------|
| 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, 20X9. The rates paid for such purchases are subject to review annually.

**EXHIBIT 5 – Illustrative Independent Auditor’s
Report on Compliance with Aspects of Contractual Agreements and
Regulatory Requirements for Electric Borrowers**

RUS requires that CPAs auditing RUS borrowers provide an independent auditor’s report on compliance with aspects of contractual agreements and regulatory requirements 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.

Board of Directors
Center County Electric Energy Association, Inc.
[City, State]

Independent Auditor’s Report

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Center County Electric Energy Association, Inc. (the “Company”), which comprise the balance sheet as of December 31, 20X3, and the related statements of revenue and patronage capital, changes in cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated March 2, 20X4. In accordance with *Government Auditing Standards*, we have also issued our report dated March 2, 20X4, on our consideration of the Company’s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. No reports other than the reports referred to above and our [schedule of findings and recommendations] related to our audit have been furnished to management.

In connection with our audit, nothing came to our attention that caused us to believe that the Company failed to comply with the terms, covenants, provisions, or conditions of their loan, grant, and security instruments as set forth in 7 CFR Part 1773, *Policy on Audits of Rural Utilities Service Borrowers and Grantees*, §1773.33, insofar as they relate to accounting matters as enumerated below. However, our audit was not directed primarily toward obtaining knowledge of noncompliance. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding the Company’s noncompliance with the above-referenced terms, covenants, provisions, or conditions of the contractual agreements and regulatory requirements, insofar as they relate to accounting matters. In connection with our audit, we noted no matters regarding the Company’s accounting and records to indicate that the Company did not:

Maintain adequate and effective accounting procedures;

Utilize adequate and fair methods for accumulating and recording labor, material, and overhead costs, and the distribution of these costs to construction, retirement, and maintenance or other expense accounts;

Reconcile continuing property records to the controlling general ledger plant accounts; Clear construction accounts and accrue depreciation on completed construction; Record and properly price the retirement of plant;

Seek approval of the sale, lease or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap;

Maintain adequate control over materials and supplies;

Prepare accurate and timely Financial and Operating Reports;

Obtain written RUS approval to enter into any contract for the management, operation, or maintenance of the borrower's system if the contract covers all or substantially all of the electric system;

Disclose material related party transactions in the financial statements, in accordance with requirements for related parties in generally accepted accounting principles;

Record depreciation in accordance with RUS requirements (See RUS Bulletin 183-1, Depreciation Rates and Procedures);

Comply with the requirements for the detailed schedule of deferred debits and deferred credits; and

Comply with the requirements for the detailed schedule of investments.

The purpose of this report is solely to communicate, in connection with the audit of the financial statements, on compliance with aspects of contractual agreements and the regulatory requirements for electric borrowers based on the requirements of 7 CFR Part 1773, *Policy on Audits of Rural Utilities Service Borrowers and Grantees*. Accordingly, this report is not suitable for any other purpose.

Certified Public Accountants
City, State
March 2, 20X4

EXHIBIT 6 – Illustrative Schedule of Investments in Associated Organizations

Center County Electric Energy Association, Inc.
Schedule of Findings and Recommendations For the
Fiscal Year Ended December 31, 20X3

| | |
|---|---------------------|
| Entity name | Offset Corp. |
| Principle business | Construction |
| Ownership percentage | 40% |
| Accounting method | Equity |
| Activity since original investment | |
| Original investment | \$ 1,450,000 |
| Prior years investment | 1,073,000 |
| Prior years earnings (losses) | 400,000 |
| Prior years dividends received | (25,000) |
| Book value of investment at December 31, 20X2 | \$ 2,898,000 |
| Year ended December 31, 20X3 | |
| Current year investment advances | 56,000 |
| Current year earnings (losses) | 65,000 |
| Book value of investment at December 31, 20X3 | \$3,019,000 |

EXHIBIT 7 – Illustrative Schedule of Deferred Debits and Deferred Credits

Center County Electric Energy Association, Inc.
 Schedule of Deferred Debits and Deferred Credits For
 the Fiscal Year Ended December 31, 20X3

Schedule of deferred debits and deferred credits

| | 20X3 | 20X2 | RUS Approval |
|--|----------|----------|----------------------------|
| Deferred debits Preliminary surveys and investigations | | | |
| Total deferred debits | \$28,000 | \$ 9,000 | §1767.13(d)(1) |
| | \$28,000 | \$ 9,000 | |
| Deferred credits | | | |
| Customer energy prepayments | | | |
| | \$33,000 | \$15,000 | Per Part 1767, acct #253.1 |
| Inventory Adjustment | | | |
| Total deferred credits | \$26,000 | \$38,000 | Approved by RUS |
| | \$59,000 | \$53,000 | |

EXHIBIT 8 – Illustrative Schedule of Findings and Recommendations for Electric Borrowers

Center County Electric Energy Association, Inc.
Schedule of Findings and Recommendations For the
Fiscal Year Ended December 31, 20X3

20X3 – 01 Finding

Criteria: 7 CFR 1767, Accounting Requirements for RUS Electric Borrowers, §1767.13, Departures from the Prescribed RUS Uniform System of Accounts, requires that such departures receive prior written approval of RUS before being recorded in the official records of the utility. There are five stated exceptions which may be implemented without prior written approval.

Condition: The Company implemented a deferred revenue plan in December 20X3 without requesting and receiving prior written approval of the plan.

Cause: Due to significant turnover in the Company, personnel were not aware of the requirement.

Effect or potential effect: This departure from the Uniform System of Accounts would cause the Company to be noncompliant with their security agreements which could trigger negative consequences.

Recommendation: Recommend that the Company take immediate action to secure written approval of this departure.

Management Response: Management agrees with this recommendation.

Corrective Action Planned or Taken: This matter was brought before the Board of Directors at the February Board meeting. A resolution was presented, voted on and passed at that time instructing management to take action to request written approval of the plan. The request was submitted to RUS on March 2, 20X4, and written approval was received from RUS in a letter dated March 26, 20X4.

Note: Management's response and the corrective action plan must be submitted separately and not included in this schedule (see §1773.4 (i)).

APPENDIX B

**ILLUSTRATIVE REPORTS FOR A
COMMERCIAL TELECOMMUNICATIONS
COMPANY**

Appendix B includes an example of an auditor's report, report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with *Government Auditing Standards*, financial statements and accompanying notes, report on compliance with aspects of contractual agreements and regulatory requirements, and schedule of findings and recommendations 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 - Illustrative Auditor's Report

The Board of Directors
Center County Telecommunications Systems Inc.

Independent Auditor's Report

Report on the Financial Statements

We have audited the accompanying financial statements of Center County Telecommunications Systems, Inc., (the "Company") which comprise the balance sheets as of December 31, 20X3 and 20X2, and the related statements of revenue and patronage capital, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 20X3 and 20X2, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

[This section is used for discussing supplementary or other information.]

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated March 2, 20X4, on our consideration of the Company's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance with the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Center County Telecommunications Systems, Inc.'s internal control over financial reporting and compliance.

Certified Public Accountants

City, State

March 2, 20X4

**EXHIBIT 2 - Illustrative Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*,
(No Material Weaknesses Identified, No Significant Deficiencies Identified, No Reportable Instances of Noncompliance or Other Matters Identified)**

The Board of Directors
Center County Telecommunications Systems, Inc.

We have audited in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of Center County Telecommunications Systems, Inc. (the "Company") as of and for the years ended December 31, 20X3 and 20X2, and the related notes to the financial statements, which collectively comprise the Company's basic financial statements, and have issued our report thereon dated March 2, 20X4.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Company's internal control over financial reporting (internal control) to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.

Accordingly, we do not express an opinion on the effectiveness of the Company's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Company's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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 or other matters that are required to be reported under *Government Auditing Standards*

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of the internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with Government Auditing Standards in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Certified Public Accountants
City, State
March 2, 20X4

**EXHIBIT 3 - Illustrative Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards
(No Material Weaknesses Identified; Significant Deficiencies Identified; and Reportable Instances of Noncompliance and Other Matters Identified)**

The Board of Directors
Center County Telecommunications Systems, Inc.

We have audited in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of Center County Telecommunications Systems, Inc. (the “Company”) as of and for the years ended December 31, 20X3 and 20X2, and the related notes to the financial statements, which collectively comprise the Company’s basic financial statements, and have issued our report thereon dated March 2, 20X4.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Company’s internal control over financial reporting (internal control) to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control.

Accordingly, we do not express an opinion on the effectiveness of the Company’s internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings and recommendations that we

consider to be significant deficiencies. [*List the reference numbers of the related findings*].

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Company's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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 or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and recommendations. [*List the reference numbers of the related findings*].

Center County Telecommunications Systems, Inc.'s Response to Findings

The Company's responses to the findings identified in our audit are described in the accompanying schedule of findings and recommendations. The Company's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of the internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. Accordingly, this communication is not suitable for any other purpose.

Certified Public Accountants
City, State
March 2, 20X4

EXHIBIT 4 - Illustrative Financial Statements

**CENTER COUNTY TELECOMMUNICATIONS SYSTEMS, INC.
BALANCE SHEETS
DECEMBER 31, 20X3 and 20X2
ASSETS**

| | 20X3 | 20X2 |
|---|---------------------|---------------------|
| 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 20X3 and \$34,000 in 20X2. | 740,000 | 667,000 |
| Materials and Supplies | 250,000 | 210,000 |
| Prepayments | 50,000 | 31,700 |
| Other Current Assets..... | 25,000 | 30,000 |
| Total Current Assets..... | \$1,151,500 | \$ 995,000 |
| Noncurrent Assets | | |
| Investments | 741,500 | 705,000 |
| Marketable Securities | 1,550,000 | 1,450,000 |
| Nonregulated..... | 39,000 | 12,000 |
| Other deferred charges | | |
| Total Noncurrent Assets | 2,330,500 | 2,167,000 |
| Property, Plant and Equipment | | |
| Telecommunications Plant in Service..... | 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 |
| 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, 20X3 and 20X2
LIABILITIES AND RETAINED EARNINGS(Note 2)**

| | 20X3 | 20X2 |
|--|---------------------|---------------------|
| 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..... | 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 20X3 and 20X2..... | 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, 20X3
and 20X2**

| | 20X3 | 20X2 |
|---|--------------------|--------------------|
| 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) | | |
| 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, 20X3 and 20X2**

| | 20X3 | 20X2 |
|---|-------------|-------------|
| 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, 20X3 and 20X2**

| | 20X3 | 20X2 |
|---|-------------|-------------|
| 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 |
| Cash - End of Year..... | 60,500 | 32,300 |

The accompanying notes are an integral part of these statements.

**RECONCILIATION OF NET MARGINS TO NET
CASH PROVIDED BY OPERATING**

| | 20X3 | 20X2 |
|---|--------------------|--------------------|
| 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 | 1,395,400 | 959,000 |
| 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, 20X3 AND 20X2**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

[Include a brief description of the reporting entity’s significant accounting policies in accordance with ASC 235, Notes to Financial Statements.

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, 20X3 and 20X2:

| | 20X3 | 20X2 |
|-------------------------|----------|----------|
| 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 Systems, Inc., records investments in accordance with the provisions of ASC 320, Investments – Debt and Equity Securities. In accordance with the criteria provided in ASC 320, 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, 20X3 and 20X2 were:

| 20X3 | | | | |
|---|----------------|-----------------------|-----------------------|------------|
| Description | 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 |
| | \$762,500 | \$8,900 | \$3,900 | \$767,500 |
| 20X2 | | | | |
| Description | 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, 20X3, 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, 20X3 and 20X2, 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:

| | 20X3 | 20X2 |
|--------------------------------------|-------------|-------------|
| 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, 20X3 and 20X2

| | 20X3 | 20X2 |
|---------------|-----------|-----------|
| 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 20X3 and \$12,000 in 20X2.

5. INVESTMENT IN TELEPHONE PLANT:

Telephone Plant in Service and under construction is stated at cost. Listed below are the major classes of the telecommunications plant as of December 31, 20X3 and 20X2:

| | 20X3 | 20X2 |
|-------------------------------------|--------------|--------------|
| 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 telephone plant in service was 7.2 percent in 20X3 and 7.1 percent in 20X2.

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, 20X3 and 20X2:

| | 20X3 | 20X2 |
|---------------------------------------|-------------|-------------|
| 2% Notes due September 30, 20X8 | \$2,495,000 | \$2,373,000 |
| 5% Notes due March 31, 20X2..... | 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, 20X3, 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, 20X3, annual maturities of long-term debt outstanding for the next five years are as follows:

| | |
|------------|-----------|
| 20X4..... | \$579,000 |
| 20X5..... | 600,000 |
| 20X6 | 612,000 |
| 20X7..... | 624,000 |
| 20X8..... | 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. PENSION PLAN (DEFINED BENEFITS):

Pension benefits for substantially all employees of the Company are provided through participation in the ABC Retirement Security Plan (Plan), a defined benefit plan qualified under Section 401 and tax-exempt under 501(a) of the Internal Revenue Code. The plan sponsor's employer identification number is 55-5555555 and the plan number is 555.

A unique characteristic of a multiemployer plan compared to a single employer plan is that all plan assets are available to pay benefits of any plan participant. Separate asset accounts are not maintained for participating employers. This means that assets contributed by one employer may be used to provide benefits to employees of another participating employer.

In the Plan, a “zone status” determination is not required, and therefore not determined, under the Pension Protection Act (PPA) of 2006. In addition, the accumulated benefit obligations and plan assets are not determined or allocated separately by individual employer. In total, the Plan was greater than 80 percent funded at January 1, 20X4 and 20X3 based on the PPA funding target and PPA actuarial value of assets on those dates.

Because the provisions of the PPA do not apply to the Plan, funding improvement plans and surcharges are not applicable. Future contribution requirements are determined each year as a part of the actuarial valuation of the plan and may change as a result of plan experience. The Company’s annual contribution to the program represented less than 5 percent of total contribution made to the plan by all participating employers and are equal to the amounts recorded for pension cost. Contributions were \$144,000 and \$203,000 for the years ended December 31, 20X3 and 20X2, respectively.

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, | |
|-------------------------------------|--------------|-----------|
| | 20X3 | 20X2 |
| 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, | |
|-------------------------------|--------------|-----------|
| | 20X3 | 20X2 |
| 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, 20X3. The amount unpaid against these commitments at December 31, 20X3 is \$1,100,000.

EXHIBIT 5 - Illustrative Independent Auditors' Report on Compliance with Aspects of Contractual Agreements and Regulatory Requirements for Telecommunications Borrowers

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

Board of Directors
Center County Telecommunications Systems, Inc.
[City, State]

Independent Auditor's Report

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Center County Telecommunications Systems, Inc. (the "Company"), which comprise the balance sheet as of December 31, 20X3, and the related statements of revenue and patronage capital, changes in cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated March 2, 20X4. In accordance with *Government Auditing Standards*, we have also issued our report dated March 2, 20X4, on our consideration of the Company's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. No reports other than the reports referred to above and our schedule of findings and recommendations related to our audit have been furnished to management.

In connection with our audit, nothing came to our attention that caused us to believe that the Company failed to comply with the terms, covenants, provisions, or conditions of their loan, grant, and security instruments as set forth in 7 CFR Part 1773, *Policy on Audits of Rural Utilities Service Borrowers and Grantees*, §1773.33, insofar as they relate to accounting matters as enumerated below. However, our audit was not directed primarily toward obtaining knowledge of noncompliance. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding the Company's noncompliance with the above-referenced terms, covenants, provisions, or conditions of the contractual agreements and regulatory requirements, insofar as they relate to accounting matters. In connection with our audit, we noted no matters regarding the Company's accounting and records to indicate that the Company did not:

Maintain adequate and effective accounting procedures;

Utilize adequate and fair methods for accumulating and recording labor, material, and overhead costs, and the distribution of these costs to construction, retirement, and maintenance or other expense accounts;

Reconcile continuing property records to the controlling general ledger plant accounts; Clear

construction accounts and accrue depreciation on completed construction; Record and properly

price the retirement of plant;

Seek approval of the sale, lease or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap;

Maintain adequate control over materials and supplies;

Prepare accurate and timely Financial and Operating Reports;

Obtain written RUS approval to enter into any contract, agreement, or lease with an affiliate as defined in § 1773.33(d)(2)(i);

Disclose material related party transactions in the financial statements, in accordance with requirements for related parties in generally accepted accounting principles;

Comply with the requirements for the detailed schedule of investments.

The purpose of this report is solely to communicate, in connection with the audit of the financial statements, on compliance with aspects of contractual agreements and the regulatory requirements for telecommunications borrowers based on the requirements of 7 CFR Part 1773, *Policy on Audits of Rural Utilities Service Borrowers and Grantees*. Accordingly, this report is not suitable for any other purpose.

Certified Public Accountants

City, State

March 2, 20X4

**EXHIBIT 6 – Illustrative Schedule of Findings and Recommendations for
Telecommunications Borrowers**

Center County Telecommunications Systems, Inc.
Schedule of Findings and Recommendations For
the Fiscal Year Ended December 31, 20X3

20X3 – 01 Finding

Criteria: 47 CFR 32, Uniform System of Accounts, as modified by 7 CFR 1770, Supplementary Accounts Required of RUS Telephone Borrowers, §32.2000 (f), standard practices for establishing and maintaining continuing property records, requires that continuing property records include the description, location, date of placement, essential details of construction, and the original cost of the property record units.

Condition: The Company failed to maintain continuing property records for construction completed since 20X0.

Cause: The Company has been in an accelerated construction phase and has not placed sufficient emphasis on the requirement to establish and maintain continuing property records.

Effect or potential effect: The absence of continuing property records have led to misstatements of the balance sheet and income statement because the plant records are understated and the depreciation expense associated with this plant is also understated.

Recommendation: Recommend that the Company develop a plan of action to establish the required continuing property records and to maintain them.

Management Response: Management agrees with this recommendation.

Corrective Action Planned or Taken: Management is in the process of bidding a contract to secure the services of a firm which will be able to recreate accurate continuing property records and to determine the adjustments which are required to properly record the plant and associated expenses in order to issue audited financial statement which fairly present the position and operations of the Company.

Note: Management's response and the corrective action plan must be submitted separately and not included in this schedule (see §1773.4 (i)).

APPENDIX C

ILLUSTRATIVE REPORTS FOR BROADBAND BORROWERS

Appendix C includes an example of an auditor's report, report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with *Government Auditing Standards*, financial statements and accompanying notes, report on compliance with aspects of contractual agreements and regulatory requirements and schedule of findings and recommendations for a broadband borrower. 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 broadband borrowers.

EXHIBIT 1 - SAMPLE AUDITOR'S REPORT

The Board of Directors Starry
Night Broadband, Inc.

Independent Auditor's Report

Report on the Financial Statements

We have audited the accompanying financial statements of Starry Night Broadband, Inc., (the "Company") which comprise the balance sheets as of December 31, 20X3 and 20X2, and the related statements of income and stockholder's equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 20X3 and 20X2, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

[This section is used for discussing supplementary or other information.]

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated March 2, 20X4, on our consideration of the Company's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance with the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Starry Night Broadband, Inc.'s internal control over financial reporting and compliance.

Certified Public Accountants

City, State

March 2, 20X4

**EXHIBIT 2 - Illustrative Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*,
(No Material Weaknesses Identified, No Significant Deficiencies Identified, No Reportable Instances of Noncompliance or Other Matters Identified)**

The Board of Directors Starry
Night Broadband, Inc.

We have audited in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of Starry Night Broadband, Inc. (the “Company”) as of and for the years ended December 31, 20X3 and 20X2, and the related notes to the financial statements, which collectively comprise the Company’s basic financial statements, and have issued our report thereon dated March 2, 20X4.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Company’s internal control over financial reporting (internal control) to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control.

Accordingly, we do not express an opinion on the effectiveness of the Company’s internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Company's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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 or other matters that are required to be reported under *Government Auditing Standards*

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of the internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with Government Auditing Standards in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Certified Public Accountants
City, State
March 2, 20X4

**EXHIBIT 3 - Illustrative Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards
(No Material Weaknesses Identified; Significant Deficiencies Identified; and Reportable Instances of Noncompliance and Other Matters Identified)**

The Board of Directors Starry
Night Broadband, Inc.

We have audited in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of Starry Night Broadband, Inc. (the “Company”) as of and for the years ended December 31, 20X3 and 20X2, and the related notes to the financial statements, which collectively comprise the Company’s basic financial statements, and have issued our report thereon dated March 2, 20X4.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Company’s internal control over financial reporting (internal control) to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control.

Accordingly, we do not express an opinion on the effectiveness of the Company’s internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings and recommendations that we

consider to be significant deficiencies. [*List the reference numbers of the related findings*].

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Company's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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 or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and recommendations. [*List the reference numbers of the related findings*].

Starry Night Broadband, Inc.'s Response to Findings

The Company's responses to the findings identified in our audit are described in the accompanying schedule of findings and recommendations. The Company's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of the internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with Government Auditing Standards in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Certified Public Accountants

City, State

March 2, 20X4

EXHIBIT 4 - Illustrative Financial Statements

**STARRY NIGHT BROADBAND, INC.
BALANCE SHEETS
DECEMBER 31, 20X3 and 20X2
ASSETS (Notes 1 and 2)**

| | 20X3 | 20X2 |
|---|----------------------|----------------------|
| Current Assets | | |
| Cash and cash equivalents | \$ 3,315,990 | \$ 2,763,078 |
| Accounts Receivable, less allowance for doubtful accounts of \$30,792 in 20X3 and \$48,119 in 20X2 | | |
| Interest Receivable | 614,110 | 796,324 |
| Prepaid expenses | 11,816 | 15,480 |
| Material and supplies | 161,713 | 192,744 |
| Total Current Assets | 911,653 | 759,826 |
| | 5,015,282 | 4,527,452 |
| Noncurrent Assets | | |
| Other investments | | |
| Certificates of deposit..... | 253,628 | 289,744 |
| Intangibles assets, net of amortization..... | 624,705 | 707,204 |
| Total noncurrent assets..... | 98,896 | 110,696 |
| | 977,229 | 1,107,644 |
| Property, Plant and Equipment | | |
| Telecommunications plant in service | 50,677,948 | 39,500,279 |
| Other communications plant | 1,009,839 | 711,891 |
| Cable Television plant..... | 26,826,496 | 25,187,018 |
| | 78,514,283 | 65,399,188 |
| Less accumulated depreciation..... | 29,919,841 | 25,618,725 |
| | 48,594,442 | 39,780,463 |
| Plant under construction | 7,037,340 | 2,033,978 |
| Total property, plant and equipment..... | 55,631,782 | 41,814,441 |
| | | |
| Total Assets | \$ 61,624,293 | \$ 47,449,537 |

The accompanying notes are an integral part of these statements.

STARRY NIGHT BROADBAND, INC.
BALANCE SHEETS
DECEMBER 31, 20X3 and 20X2
LIABILITIES AND RETAINED EARNINGS (Note 2)

| | 20X3 | 20X2 |
|---|----------------------|----------------------|
| Current Liabilities | | |
| Current maturities on long-term debt..... | \$ 1,446,793 | \$ 929,000 |
| Accounts payable..... | 1,405,586 | 1,112,624 |
| Advanced billings and customer deposits | 97,953 | 75,170 |
| Other accrued liabilities..... | 140,965 | 134,570 |
| Total current liabilities | 3,091,297 | 2,261,364 |
| Noncurrent liabilities and deferred credits | | |
| Payable to related party | 7,268,640 | 6,714,962 |
| Deferred grant revenue, less current portion..... | 4,463,420 | 4,477,864 |
| Deferred income taxes..... | 4,180,589 | 5,953,115 |
| Long-term debt, less current maturities (Note 4)... | 23,976,059 | 12,586,747 |
| Total noncurrent liabilities and deferred credits..... | 39,888,708 | 29,732,688 |
| Stockholder's Equities | | |
| Capital Stock - Common \$1 par value-10,260,000 shares authorized; 7,111,613 outstanding 20X3 and 20X2..... | 7,111,613 | 7,111,613 |
| Additional Paid-in Capital | 3,882,076 | 1,522,985 |
| Retained Earnings..... | 7,650,599 | 6,820,887 |
| Total Stockholder's Equities | 18,644,288 | 15,455,485 |
| Total Equities and Liabilities | \$ 61,624,293 | \$ 47,449,537 |

The accompanying notes are an integral part of these statements.

STARRY NIGHT BROADBAND, INC.
STATEMENTS OF INCOME AND RETAINED EARNINGS
FOR THE YEARS ENDED DECEMBER 31, 20X3 and 20X2

| | 20X3 | 20X2 |
|--|----------------------|----------------------|
| Revenues | | |
| Local network services..... | \$ 3,112,823 | \$ 3,123,276 |
| Network access services..... | 2,361,996 | 2,615,180 |
| Long distance network services | 1,421,992 | 1,421,897 |
| Cable television service | 7,038,322 | 6,410,994 |
| Internet services..... | 5,067,369 | 4,913,323 |
| Retail equipment sales..... | 1,523,021 | 1,955,889 |
| Leased equipment revenue..... | 1,759,794 | 1,881,155 |
| Miscellaneous revenue | 1,176,647 | 1,076,137 |
| Uncollectibles | (35,405) | (37,166) |
| Total Operating Revenues | \$ 23,426,559 | \$ 23,360,685 |
| Operating Expenses | | |
| Plant specific operations | 1,682,086 | 1,264,924 |
| Plant nonspecific operations | 2,399,847 | 2,426,729 |
| Maintenance | 1,798,120 | 1,664,953 |
| Cost of cable television programming | 5,715,359 | 4,484,349 |
| Depreciation and amortization | 6,308,512 | 5,255,874 |
| Customer operations..... | 3,335,192 | 3,305,517 |
| Corporate operations | 1,268,692 | 1,175,190 |
| Cost of retail equipment sales | 1,117,297 | 1,508,233 |
| Other operating expenses..... | 120,343 | 113,579 |
| Total Operating Expenses..... | 23,745,448 | 21,199,348 |
| Operating (Loss) Income | \$ (318,889) | \$ 2,161,337 |
| Other Income (Expense) | | |
| Interest income..... | 21,798 | 23,393 |
| Interest expense..... | (645,723) | (371,654) |
| Net Other Income and Expenses | (623,925) | (348,261) |
| (Loss) Income Before Income Taxes | \$ (942,814) | \$ 1,813,076 |
| Benefit from (Provision for) Income Taxes | 1,772,526 | (674,545) |
| Net Income for the Period | \$829,712 | \$ 1,138,531 |
| Retained Earnings at Beginning of Year | 6,820,887 | 5,682,356 |
| Retained Earnings at End of Year | \$7,650,599 | \$6,820,887 |

The accompanying notes are an integral part of these statements.

**STARRY NIGHT BROADBAND, INC.
STATEMENTS OF CASH FLOWS**

FOR THE YEARS ENDED DECEMBER 31, 20X3 and 20X2

| | 20X3 | 20X2 |
|---|---------------|---------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Cash Received from Consumers | \$ 23,608,773 | \$ 23,446,329 |
| Cash Paid to Suppliers and Employee..... | (17,640,322) | (16,037,012) |
| Interest Received | 18,134 | 27,210 |
| Interest Paid | (645,723) | (371,654) |
| Net Cash Provided by Operating Activities | 5,340,862 | 7,064,873 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Construction and Acquisition of Plant..... | (20,762,983) | (11,711,221) |
| Changes in amounts due from related parties | 4,239,357 | (959,849) |
| Grant funds received..... | 240,183 | - |
| (Increase) Decrease In:..... | | |
| Materials Inventory..... | (151,827) | 59,817 |
| Other Investments..... | 56,498 | 135,025 |
| Proceeds from temporary investments..... | - | 100,000 |
| Net Cash Used in Investing Activities..... | (3,012,900) | (2,782,500) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Debt Proceeds | 12,732,147 | 7,760,479 |
| Payments on Long-Term Debt | (1,259,368) | (732,249) |
| Increase/(Decrease) in: | | |
| Consumer Deposits and Advance Payments..... | 22,783 | (12,727) |
| Net Cash Provided by Financing Activities..... | 11,495,562 | 7,015,503 |
| Net Increase/(Decrease) in Cash | 457,652 | 1,704,148 |
| Cash - Beginning of Year | 1,735,128 | 30,980 |
| Cash - End of Year..... | \$ 2,192,780 | \$ 1,735,128 |

The accompanying notes are an integral part of these statements.

**RECONCILIATION OF NET MARGINS TO NET
CASH PROVIDED BY OPERATING**

| | | |
|--|--------------------|--------------------|
| Net Margins | | |
| Adjustments to Reconcile Net Margins to Net | | |
| Cash Provided by Operating Activities: | | |
| Depreciation and Amortization | 6,308,512 | 5,255,874 |
| Recognition of deferred grant revenue..... | (254,627) | (250,388) |
| Noncash patronage capital allocation | (20,382) | (23,641) |
| Noncash reinvestment of temporary investments | (12,761) | (5,086) |
| Deferred income tax..... | (1,772,526) | 767,546 |
| (Increase)/Decrease In:..... | | |
| Customer and Other Accounts Receivable | 182,214 | 85,644 |
| Interest receivable..... | 3,664 | (3,817) |
| Prepayments | 31,031 | 22,165 |
| Increase/(Decrease) In:..... | | |
| Accounts Payable | 39,630 | 71,873 |
| Other Current and Accrued Liabilities | 6,395 | 6,172 |
| Total Adjustments | 4,511,150 | 5,926,342 |
| Net Cash Provided by Operating Activities | \$5,340,862 | \$7,064,873 |

| | 20X3 | 20X2 |
|--|-------------|--------------|
| | \$ 829,712 | \$ 1,138,531 |
| | | |
| | 6,308,512 | 5,255,874 |
| | (254,627) | (250,388) |
| | (20,382) | (23,641) |
| | (12,761) | (5,086) |
| | (1,772,526) | 767,546 |
| | | |
| | 182,214 | 85,644 |
| | 3,664 | (3,817) |
| | 31,031 | 22,165 |
| | | |
| | 39,630 | 71,873 |
| | 6,395 | 6,172 |
| | 4,511,150 | 5,926,342 |
| | \$5,340,862 | \$7,064,873 |

The accompanying notes are an integral part of these statements.

**RURAL COMMUNICATIONS NETWORK,
INC. NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 20X3 AND 20X2**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

[Include a brief description of the reporting entity’s significant accounting policies in accordance with ASC Topic 235, Notes to Financial Statements.

Disclosure of accounting policies should identify and describe the accounting principles followed by the grantee 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. OTHER INVESTMENTS

| | 20X3 | 20X2 |
|--|------------|------------|
| CoBank | \$ 80,711 | \$ 132,439 |
| National Information Solutions Cooperative | 148,462 | 134,633 |
| Other | 24,455 | 22,672 |
| Total Other Investments | \$ 253,628 | \$ 289,744 |

3. PROPERTY, PLANT ANDEQUIPMENT

Telephone and Video Plant in Service and under construction is stated at cost. Listed below are the major classes of the plant as of December 31, 20X3 and 20X2:

| | 20X3 | 20X2 |
|--|------------|------------|
| Telephone Plant in Service: | | |
| Land and support assets | \$ 232,535 | \$ 176,998 |
| Central office switching equipment | 837,281 | 837,281 |
| Central office transmission | 8,068,606 | 6,245,384 |
| Cable and wire facilities assets..... | 41,539,526 | 32,240,616 |
| Subtotal | 50,677,948 | 39,500,279 |
| Other Communications Plant | | |
| Leased equipment | 276,111 | 30,659 |

| | | |
|---|--------------|--------------|
| Furniture and equipment..... | 639 | 639 |
| Internet equipment..... | 733,089 | 680,593 |
| Subtotal | 1,009,839 | 711,891 |
| Cable Television Plant | | |
| Headend equipment | 12,918,254 | 11,184,417 |
| Distribution plant | 11,835,672 | 12,036,972 |
| Support assets..... | 2,063,520 | 1,956,579 |
| Land..... | 9,050 | 9,050 |
| Subtotal | 26,826,496 | 25,187,018 |
| Total telecommunications and other plant in service | 78,514,283 | 65,399,188 |
| Construction work in process | 7,037,340 | 2,033,978 |
| Total Property, Plant and Equipment | \$85,551,623 | \$67,433,166 |

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 telephone plant in service was 7.3 percent in 20X3 and 7.8 percent in 20X2.

4. LONG-TERM DEBT

| | 20X3 | 20X2 |
|---|----------------------|----------------------|
| USDA/RD/RUS Notes (Broadband) | | |
| 3.15% Final maturity 2032 | \$ 19,779,212 | \$ 7,760,479 |
| 2.75% Final maturity 2035 | 4,576,856 | 4,517,906 |
| | 24,356,068 | 12,278,385 |
| Note Payable – 1 st Bank & Trust; 5.5% Final maturity 2018 | 548,919 | 671,422 |
| Capital lease obligation | 517,865 | 565,940 |
| Total Debt | 25,422,852 | 13,515,747 |
| Less Current Maturities | (1,446,793) | (929,000) |
| | <u>\$ 23,976,059</u> | <u>\$ 12,586,747</u> |

Substantially all assets are pledged as security for the debt, except for the note payable from above, which is unsecured. The covenants require the Company to meet certain financial ratios. The Company was in compliance with or obtained waivers for all covenants at December 31, 20X3 and 20X2.

It is estimated that principal repayments on the capital lease and long-term debt obligation for the next five years ending December 31 are as follows:

| | RD/RUS | 1 st Bank & Trust | Capital Leases | Total |
|------|--------------|------------------------------|----------------|--------------|
| 20X4 | \$ 1,047,048 | \$ 129,532 | \$ 270,213 | \$ 1,446,793 |
| 20X5 | 1,078,332 | 136,668 | 129,287 | 1,207,619 |
| 20X6 | 1,110,803 | 144,197 | 118,365 | 1,229,168 |
| 20X7 | 1,141,478 | 138,522 | | 1,141,478 |
| 20X8 | 1,180,000 | | | 1,180,000 |

5. RELATED PARTY TRANSACTIONS

Corporation X owns 100% of the issued and outstanding shares of the Company. Due to the entities being under common control, the operating results or financial position of the entity could be significantly different from those that would have been obtained if the entities were autonomous.

Corporation X provides certain management, customer service, billing and collection, and other services and facilities to the Company. Charges per operation and maintenance agreements were \$5,250,000 and \$5,000,000 for the years ended December 31, 20X3 and 20X2, respectively.

6. AMERICAN RECOVERY AND REINVESTMENT ACT LOAN AND GRANT PROGRAM

The Company was awarded a loan/grant pursuant to the American Recovery and Reinvestment Act of 2009 to finance the construction of a broadband infrastructure project in rural areas. The project was funded with USDA loans totaling \$5,782,361 and a grant in the same amount through the Broadband Initiatives Program, administered by RUS. The Company is required to contribute 25% of the project cost. The Company received grant and loan funds of \$4,968,435 and \$4,968,435, respectively, through December 31, 20X3. These loans have a final maturity date of July 18, 20Y5. The grant funds received have been recorded as deferred revenue on the balance sheet and are being recognized as revenue over the average estimated useful life of the property purchased and constructed which is 19 years.

Total revenue recognized is \$254,628 and \$250,388 for the years ending December 31, 20X3 and 20X2, respectively. This revenue has been recorded as miscellaneous in the statement of income.

**EXHIBIT 5 - Illustrative Independent Auditors' Report on Compliance with Aspects
of Contractual Agreements and Regulatory Requirements for Grantees**

RUS requires that CPAs auditing RUS borrowers provide a report on compliance with aspects of contractual agreements and regulatory requirements 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.

Board of Directors
Starry Night Broadband, Inc.
[City, State]

Independent Auditor's Report

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Starry Night Broadband, Inc., (the "Company") which comprise the balance sheet as of December 31, 20X3, and the related statements of revenue and patronage capital, changes in cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated March 2, 20X4. In accordance with *Government Auditing Standards*, we have also issued our report dated March 2, 20X4, on our consideration of the Company's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. No reports other than the reports referred to above and our schedule of findings and recommendations related to our audit have been furnished to management.

In connection with our audit, nothing came to our attention that caused us to believe that the Company failed to comply with the terms, covenants, provisions, or conditions of their loan, grant, and security instruments as set forth in 7 CFR Part 1773, *Policy on Audits of Rural Utilities Service Borrowers and Grantees*, §1773.33, insofar as they relate to accounting matters as enumerated below. However, our audit was not directed primarily toward obtaining knowledge of noncompliance. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding the Company's noncompliance with the above-referenced terms, covenants, provisions, or conditions of the contractual agreements and regulatory requirements, insofar as they relate to accounting matters. In connection with our audit, we noted no matters regarding the Company's accounting and records to indicate that Starry Night Broadband, Inc. did not:

Maintain adequate and effective accounting procedures;

Utilize adequate and fair methods for accumulating and recording labor, material, and overhead costs, and the distribution of these costs to construction, retirement, and maintenance or other expense accounts;

Reconcile continuing property records to the controlling general ledger plant accounts; Clear construction accounts and accrue depreciation on completed construction; Record and properly price the retirement of plant;

Maintain adequate control over materials and supplies;

Prepare and submit accurate and timely Financial & Statistical Reports.

Disclose material related party transactions in the financial statements, in accordance with requirements for related parties in generally accepted accounting principles;

Comply with the requirements for the detailed schedule of investments.

The purpose of this report is solely to communicate, in connection with the audit of the financial statements, on compliance with aspects of contractual agreements and the regulatory requirements for telecommunications borrowers based on the requirements of 7 CFR Part 1773, *Policy on Audits of Rural Utilities Service Borrowers and Grantees*. Accordingly, this report is not suitable for any other purpose.

Certified Public Accountants

City, State

March 2, 20X4

**EXHIBIT 6 – Illustrative Schedule of Findings and Recommendations for
Broadband Borrowers**

Starry Night Broadband, Inc.
Schedule of Findings and Recommendations For
the Fiscal Year Ended December 31, 20X3

20X3 – 01 Finding

Criteria: Inventory management requires that access to inventory be controlled at the warehouse to ensure proper control of material and supplies and to provide for physical security of company assets.

Condition: Obsolete inventory is included in the materials and supplies balance.

Cause: Obsolete inventory was stored in the warehouse along with current inventory. No one was responsible for the warehouse which allowed employees to remove and add anything to the warehouse with not control points.

Effect or potential effect: This resulted in an overstatement of inventory and an overstatement of net income.

Recommendation: Institute a policy of physically segregating and labeling obsolete inventory. Provide training to employees performing physical counts of inventory to ensure accuracy.

Assign responsibility to one manager.

Management Response: Management agrees with this recommendation.

Corrective Action Planned or Taken: Management is in the process of establishing inventory control procedures and of recruiting a warehouse manager. They are also in the process of configuring the warehouse to limit access to inventory.

Note: Management's response and the corrective action plan must be submitted separately and not included in this schedule (see §1773.4 (i)).

APPENDIX D

ILLUSTRATIVE REPORTS FOR

GRANTEES

Appendix D includes an example of an auditor's report, report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with *Government Auditing Standards*, financial statements and accompanying notes, report on compliance with aspects of contractual agreements and regulatory requirements and schedule of findings and recommendations for a grantee. 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 auditor's reports for grantees.

EXHIBIT 1 – Illustrative Auditor's Report

The Board of Directors Rural
Network Systems, Inc.

Independent Auditor's Report

Report on the Financial Statements

We have audited the accompanying financial statements of Rural Network Systems, Inc., (the “Company”) which comprise the balance sheets as of December 31, 20X3 and 20X2, and the related statements of income and stockholder’s equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management’s Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor’s Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 20X3 and 20X2, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

[This section is used for discussing supplementary or other information.]

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated March 2, 20X4, on our consideration of the Company's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance with the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Company's internal control over financial reporting and compliance.

Certified Public Accountants

City, State

March 2, 20X4

**EXHIBIT 2 - Illustrative Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*,
(No Material Weaknesses Identified, No Significant Deficiencies Identified, No Reportable Instances of Noncompliance or Other Matters Identified)**

The Board of Directors Rural
Network Systems, Inc.

We have audited in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of Rural Network Systems, Inc. (the “Company”) as of and for the years ended December 31, 20X3 and 20X2, and the related notes to the financial statements, which collectively comprise the Company’s basic financial statements, and have issued our report thereon dated March 2, 20X4.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Company’s internal control over financial reporting (internal control) to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control.

Accordingly, we do not express an opinion on the effectiveness of the Company’s internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Company's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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 or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of the internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with Government Auditing Standards in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Certified Public Accountants
City, State
March 2, 20X4

**EXHIBIT 3 - Illustrative Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards
(No Material Weaknesses Identified; Significant Deficiencies Identified; and Reportable Instances of Noncompliance and Other Matters Identified)**

The Board of Directors Rural
Network Systems, Inc.

We have audited in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of Rural Network Systems, Inc. (the “Company”) as of and for the years ended December 31, 20X3 and 20X2, and the related notes to the financial statements, which collectively comprise the Company’s basic financial statements, and have issued our report thereon dated March 2, 20X4.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Company’s internal control over financial reporting (internal control) to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control

Accordingly, we do not express an opinion on the effectiveness of the Company’s internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings and recommendations that we

consider to be significant deficiencies. [*List the reference numbers of the related findings*].

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Company's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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 or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and recommendations. [*List the reference numbers of the related findings*].

Rural Network Systems, Inc.'s Response to Findings

The Company's responses to the findings identified in our audit are described in the accompanying schedule of findings and recommendations. The Company's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of the internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with Government Auditing Standards in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Certified Public Accountants
City, State
March 2, 20X4

EXHIBIT 4 - Illustrative Financial Statements

**RURAL NETWORKS SYSTEMS, INC.
BALANCE SHEETS
DECEMBER 31, 20X3 and 20X2
ASSETS (Notes 1 and 2)**

| | 20X3 | 20X2 |
|---|--------------|--------------|
| Current Assets | | |
| Cash and cash equivalents | \$ 1,107,000 | \$ 891,000 |
| Other Investments..... | 500,000 | 500,000 |
| Accounts Receivable, less allowance for doubtful accounts of \$1,210 in 20X3 and \$1,201 in 20X2 | 49,454 | 49,068 |
| Material and supplies | 270,000 | 245,000 |
| Total Current Assets | 1,926,545 | 1,685,068 |
| Noncurrent Assets | | |
| Other investments | 250,000 | 250,000 |
| Total noncurrent assets..... | 250,000 | 250,000 |
| Property, Plant and Equipment | | |
| Land | 500,000 | 500,000 |
| Buildings | 2,500,000 | 2,550,000 |
| Equipment | 945,000 | 545,000 |
| | 3,945,000 | 3,595,000 |
| Less accumulated depreciation..... | 1,305,000 | 1,186,000 |
| | 2,640,000 | 2,409,000 |
| Plant under construction | 128,000 | 135,000 |
| Total property, plant and equipment..... | 2,768,000 | 2,544,000 |
| Total Assets | \$ 4,944,454 | \$ 4,479,068 |

The accompanying notes are an integral part of these statements.

RURAL NETWORKS SYSTEMS, INC.
BALANCE SHEETS
DECEMBER 31, 20X3 and 20X2
LIABILITIES AND RETAINED EARNINGS (Note
2)

| | 20X3 | 20X2 |
|--|---------------------|---------------------|
| Current Liabilities | | |
| Current portion of deferred grant revenue..... | \$ 25,000 | \$ 25,000 |
| Accounts payable..... | 189,575 | 438,512 |
| Total current liabilities | 214,575 | 463,512 |
| Noncurrent liabilities and deferred credits | | |
| Deferred grant revenue, less current portion..... | 650,000 | 425,000 |
| Total noncurrent liabilities and deferred credits..... | 650,000 | 425,000 |
| Stockholder's Equities | | |
| Capital Stock - Common \$100 par value-1,000 shares authorized and outstanding in 20X3 and 20X2..... | 100,000 | 100,000 |
| Retained Earnings..... | 3,979,879 | 3,490,556 |
| Total Stockholder's Equities | 4,079,879 | 3,590,556 |
| Total Equities and Liabilities | \$ 4,944,454 | \$ 4,479,068 |

The accompanying notes are an integral part of these statements.

RURAL NETWORKS SYSTEMS, INC.
STATEMENTS OF INCOME AND RETAINED EARNINGS
FOR THE YEARS ENDED DECEMBER 31, 20X3 and 20X2

| | 20X3 | 20X2 |
|---|--------------|--------------|
| Operating Revenues | | |
| Sales | \$ 1,155,000 | \$ 1,147,000 |
| Fees | 935 | 850 |
| Grant revenue | 25,000 | 25,000 |
| Miscellaneous revenue | 5,970 | 4,790 |
| Total Operating Revenues | \$ 1,186,905 | \$ 1,177,640 |
| Operating Expenses | | |
| Salaries | 253,000 | 249,000 |
| Insurance | 6,000 | 6,000 |
| Legal and accounting | 7,500 | 7,500 |
| Office supplies..... | 1,275 | 1,197 |
| Depreciation and amortization | 119,000 | 115,000 |
| operating supplies | 1,225 | 1,143 |
| Repairs and maintenance | 16,750 | 17,585 |
| Payroll and other taxes | 19,860 | 19,546 |
| Utilities | 11,960 | 11,720 |
| Other operating expenses..... | 11,436 | 11,358 |
| Total Operating Expenses..... | 448,006 | 440,049 |
| Operating (Loss) Income | \$ 738,899 | \$ 737,591 |
| Other Income (Expense) | | |
| Interest and dividend income | 2,500 | 2,500 |
| Net Other Income and Expenses | 2,500 | 2,500 |
| (Loss) Income Before Income Taxes | \$ 741,399 | \$ 740,091 |
| Income Taxes | 252,076 | 251,631 |
| Net Income for the Period | \$ 489,323 | \$ 488,460 |
| Retained Earnings at Beginning of Year | 3,490,556 | 3,002,096 |
| Retained Earnings at End of Year | \$ 3,979,879 | \$ 3,490,556 |

The accompanying notes are an integral part of these statements.

RURAL NETWORKS SYSTEMS, INC.
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 20X3 and 20X2

| | 20X3 | 20X2 |
|---|--------------|--------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Cash Received from Consumers | \$ 1,161,519 | \$ 1,178,363 |
| Cash Paid to Suppliers..... | (349,943) | (300,766) |
| Cash Paid to Employees..... | (253,000) | (249,000) |
| Interest Received | 2,500 | 2,500 |
| Taxes Paid | (252,076) | (251,631) |
| Net Cash Provided by Operating Activities | 309,000 | 379,466 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Construction and Acquisition of Plant..... | (343,000) | (293,000) |
| Net Cash Used in Investing Activities..... | (343,000) | (293,000) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Grant Proceeds | 250,000 | 250,000 |
| Net Cash Provided by Financing Activities..... | 250,000 | 250,000 |
| Net Increase/(Decrease) in Cash | 216,000 | 336,466 |
| Cash - Beginning of Year | 861,000 | 554,534 |
| Cash - End of Year..... | \$ 1,107,000 | \$ 891,000 |

The accompanying notes are an integral part of these statements.

**RECONCILIATION OF NET MARGINS TO NET
CASH PROVIDED BY OPERATING**

| | 20X3 | 20X2 |
|--|------------|------------|
| Net Margins | \$ 489,323 | \$ 488,460 |
| Adjustments to Reconcile Net Margins to Net | | |
| Cash Provided by Operating Activities: | | |
| Depreciation and Amortization | 119,000 | 115,000 |
| Recognition of deferred grant revenue..... | (25,000) | (25,000) |
| (Increase)/Decrease In:..... | | |
| Accounts receivable | (386) | (723) |
| Material and supplies inventory..... | (25,000) | (112,024) |
| Increase/(Decrease) In:..... | | |
| Accounts Payable | (248,937) | (86,247) |
| Net Cash Provided by Operating Activities | \$ 309,000 | \$ 379,466 |

The accompanying notes are an integral part of these statements.

**RURAL COMMUNICATIONS NETWORK,
INC. NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 20X3 AND 20X2**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

[Include a brief description of the reporting entity’s significant accounting policies in accordance with ASC Topic 235, Notes to Financial Statements.

Disclosure of accounting policies should identify and describe the accounting principles followed by the grantee 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. OTHER INVESTMENTS

| | 20X3 | 20X2 |
|-------------------------|------------|------------|
| CitiBank | \$ 250,000 | \$ 250,000 |
| Bank of America | 250,000 | 250,000 |
| Total Other Investments | \$ 500,000 | \$ 500,000 |

3. PROPERTY, PLANT ANDEQUIPMENT

Property, plant, and equipment and under construction are stated at cost. Listed below are the major classes of the plant as of December 31, 20X3 and 20X2:

| | 20X3 | 20X2 |
|--|--------------|--------------|
| Land | \$ 500,000 | \$ 500,000 |
| Buildings..... | 2,500,000 | 2,550,000 |
| Equipment | 945,000 | 545,000 |
| Total property, plant and equipment in service | 3,945,000 | 3,595,000 |
| Construction work in process | 128,000 | 135,000 |
| Total Property, Plant and Equipment | \$ 4,073,000 | \$ 3,730,000 |

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 plant in service was 3.0 percent in 20X3 and 3.2 percent in 20X2.

4. LONG-TERM DEBT

The Company has no long-term debt.

5. RELATED PARTY TRANSACTIONS

There are no related party transactions.

6. RURAL UTILITIES SERVICE COMMUNITY CONNECT GRANT PROGRAM

In 20X1, the Company was awarded a grant through the Rural Utilities Service Community Connect Program to help fund broadband deployment into rural communities where it is not yet economically viable for private sector providers to deliver service. Grants may be used for the construction, acquisition, or leasing of facilities, spectrum, land or buildings used to deploy broadband service for all residential and business customers located within the Proposed Funded Service Area (PFSA), all participating critical community facilities (such as public schools, fire stations, and public libraries), and the cost of providing broadband service free of charge to the critical community facilities for 2 years. Less than 10% of the grant amount or up to \$150,000 may be used for the improvement, expansion, construction or acquisition of a community center that provides online access to the public.

The project was funded with a Community Connect grant totaling \$750,000 administered by RUS. The Company is required to contribute 15% of the project cost. The Company received grant funds of \$250,000 in 20X3 and 20X2.

The grant funds received have been recorded as deferred revenue on the balance sheet and are being recognized as revenue over the average estimated useful life of the property purchased and constructed which is 30 years. Total revenue recognized is \$25,000 and \$25,000 for the years ending December 31, 20X3 and 20X2, respectively.

EXHIBIT 5 - Illustrative Independent Auditor's Report on Compliance with Aspects of Contractual Agreements and Regulatory Requirements for Grantees

RUS requires that CPAs auditing RUS borrowers provide a report on compliance with aspects of contractual agreements and regulatory requirements 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.

Board of Directors
Rural Network Systems, Inc.
[City, State]

Independent Auditor's Report

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Rural Network Systems, Inc., (the "Company") which comprise the balance sheet as of December 31, 20X3, and the related statements of revenue and patronage capital, changes in cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated March 2, 20X4. In accordance with *Government Auditing Standards*, we have also issued our report dated March 2, 20X4, on our consideration of Rural Network Systems, Inc.'s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. No reports other than the reports referred to above and our schedule of findings and recommendations related to our audit have been furnished to management.

In connection with our audit, nothing came to our attention that caused us to believe that the Company failed to comply with the terms, covenants, provisions, or conditions of their loan, grant, and security instruments as set forth in 7 CFR Part 1773, *Policy on Audits of Rural Utilities Service Borrowers and Grantees*, §1773.33, insofar as they relate to accounting matters as enumerated below. However, our audit was not directed primarily toward obtaining knowledge of noncompliance. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding the Company's noncompliance with the above-referenced terms, covenants, provisions, or conditions of the contractual agreements and regulatory requirements, insofar as they relate to accounting matters. In connection with our audit, we noted no matters regarding the Company's accounting and records to indicate that the Company did not:

Maintain adequate and effective accounting procedures;

Utilize adequate and fair methods for accumulating and recording labor, material, and overhead costs, and the distribution of these costs to construction, retirement, and maintenance or other expense accounts;

Reconcile continuing property records to the controlling general ledger plant accounts; Clear construction accounts and accrue depreciation on completed construction; Record and properly price the retirement of plant;

Maintain adequate control over materials and supplies;

Prepare and submit accurate and timely Financial & Statistical Reports, Federal Financial Report, Schedule E of the Financial & Statistical Report, or Project Performance Report, as required.

Disclose material related party transactions in the financial statements, in accordance with requirements for related parties in generally accepted accounting principles;

Comply with the requirements for the detailed schedule of investments.

The purpose of this report is solely to communicate, in connection with the audit of the financial statements, on compliance with aspects of contractual agreements and the regulatory requirements for telecommunications borrowers based on the requirements of 7 CFR Part 1773, *Policy on Audits of Rural Utilities Service Borrowers and Grantees*. Accordingly, this report is not suitable for any other purpose.

Certified Public Accountants

City, State

March 2, 20X4

EXHIBIT 6 – Illustrative Schedule of Findings and Recommendations for Broadband Borrowers

Rural Network Systems, Inc.
Schedule of Findings and Recommendations For
the Fiscal Year Ended December 31, 20X3

20X3 – 01 Finding

Criteria: Inventory management requires that access to inventory be controlled at the warehouse to ensure proper control of material and supplies and to provide for physical security of company assets.

Condition: Obsolete inventory is included in the materials and supplies balance.

Cause: Obsolete inventory was stored in the warehouse along with current inventory. No one was responsible for the warehouse which allowed employees to remove and add anything to the warehouse with not control points.

Effect or potential effect: This resulted in an overstatement of inventory and an overstatement of net income.

Recommendation: Institute a policy of physically segregating and labeling obsolete inventory. Provide training to employees performing physical counts of inventory to ensure accuracy.

Assign responsibility to one manager.

Management Response: Management agrees with this recommendation.

Corrective Action Planned or Taken: Management is in the process of establishing inventory control procedures and of recruiting a warehouse manager. They are also in the process of configuring the warehouse to limit access to inventory.

Note: Management's response and the corrective action plan must be submitted separately and not included in this schedule (see §1773.4 (i)).