

does not reflect the current ability of the core utility business to meet expenses and generate a small margin. Such investments can provide needed capital to meet unexpected and unforeseeable costs arising from storm damage, litigation over service territory, and other unforeseeable events, but once used for these purposes it is not available to meet the expenses of the core utility business, and it should not be relied upon for that purpose in any event.

Based on these considerations, Operating TIER and Operating DSC have been modified to include with operating margins cash received from a borrower's G&T and creditors for patronage capital retirements. With such cash receipts included with operating margins, recent experience indicates that very few if any borrowers will have difficulty in meeting Operating TIER and Operating DSC set at the minimum level of 1.1. Even without including such cash receipts with operating margins, only 18 borrowers in 1993 and only 13 borrowers in 1994 that met the standard TIER and standard DSC requirements failed to meet an Operating TIER and Operating DSC of 1.1, based on the average of the best 2 out of 3 years. Data for a small sample of borrowers that might have some problems in meeting the operating ratios without including cash received from G&T suppliers and creditors indicate that including such cash will substantially improve their results. Moreover, § 1710.114 gives the Administrator the authority to set coverage ratios below the normal levels if he or she determines that the lower ratios are required to ensure the repayment of, and/or reasonable security for, RUS loans.

Several borrowers argued that the rate covenant should be placed in the mortgage rather than the loan contract, while several others and a multi-state borrower association argued that it was appropriate to place it in the loan contract. RUS had included the rate covenant in the proposed mortgage, but shifted it to the loan contract based on the recommendations of several public commenters and the difficulty of reaching agreement among the principal lenders to rural electric systems over exactly how the coverage ratios should be structured. The rate covenant has been retained in the loan contract.

Finally, a technical amendment has been made to the definitions of TIER and DSC contained in the model mortgage for distribution borrowers, to eliminate inconsistencies between those two terms as defined in the mortgage, and to achieve greater consistency among the definitions of TIER, DSC,

OTIER, and ODSC as those terms are defined in the mortgage, the loan contract, and in § 1710.2. "Taxes paid, if any, based upon income" has been eliminated from the numerator of TIER in the mortgage. This term was not included in the numerator of DSC in the mortgage, nor was it included in the numerators of either TIER or DSC as defined in § 1710.2 or in the numerators of either OTIER or ODSC in the proposed loan contract.

The definition of DSC contained in the mortgage has been amended by eliminating the phrase starting with "provided, however," which related to the calculation of principal and interest required to be paid on long-term debt in the event any debt is refinanced. A similar provision was not included in the definition of TIER in the mortgage, with respect to calculating interest required to be paid in the event any long-term debt is refinanced. Nor was such a provision included in the definitions of DSC, TIER, ODSC or OTIER in § 1710.2 or in the definitions of OTIER and ODSC in the proposed loan contract. Properly calculating the coverage ratios under the existing mortgage when some debt has been refinanced during the year has not been a problem, and RUS does not believe the deleted provision is needed.

Use of Standard Contract Forms

One commenter noted that proposed 7 CFR 1717.606 provides that borrowers are required to use RUS-promulgated forms of contracts for construction and for engineering and architectural services only if the construction is financed by RUS, but that 7 CFR part 1726 sets dollar limits below which RUS-promulgated forms need not be used. The commenter wondered whether § 1717.606 is intended to override the flexibility provided by the dollar thresholds in part 1726. It is not, and § 1717.606 has been revised to make that clear.

Limitations on Issuing Additional Secured Indebtedness

A commenter questioned whether the first condition in section 6.14 of the proposed loan contract on issuing additional secured debt without RUS approval should read "the Maturity of the Loan" or "the weighted average life of the loan" shall not exceed the weighted average of the expected remaining useful lives of the assets being financed. RUS agrees that it should read "weighted average life of the loan", and has made the change.

Also in section 6.14 of the proposed loan contract, a technical error was made in conforming the contract to the

formatting style of the Federal Register. This has been corrected.

System of Accounts and Outside Accountants

NRECA recommended that RUS eliminate its system of accounts and rely exclusively on the Federal Energy Regulatory Commission's (FERC) system of accounts. Aspects of this question were addressed in developing the new distribution mortgage. It was concluded that so long as there were any outstanding notes held by the government, accounting standards would be based on the RUS system of accounts. This system is exactly the same as the FERC system of accounts, except for a small number of accounts needed to account for RUS loan funds and activities specific to the cooperative form of organization. RUS believes it is essential that borrowers' financial statements be consistent from year to year and from borrower to borrower, and conform to a consistent interpretation of accounting requirements. This is necessary to meet the agency's accountability to the President and Congress for the public funds lent to borrowers.

It has been suggested that relying exclusively on FERC's system of accounts will somehow eliminate the need to obtain accounting interpretations or insulate borrowers from changes in accounting requirements and interpretations promulgated by the Financial Accounting Standards Board. This, of course, is not true, since such interpretations and changes in requirements would continue regardless of the system of accounts followed.

NRECA also recommended that RUS rely exclusively on outside accountants, apparently meaning that RUS rely in particular on outside accountants to do audits of RUS loan fund accounts. RUS believes that it is important to retain agency accountants to oversee the system of accounts, render timely responses to borrowers' accounting questions, and to continue to audit RUS loan fund accounts. Based on discussions with individual borrowers, NRECA, and other borrower organizations, RUS is proceeding with certain changes in our oversight of the system of accounts to respond to problems and concerns that have been raised, and to provide more timely responses to borrower inquiries.

Immaterial Violations of Requirements

Several commenters argued that borrowers should not be held to an absolute standard in meeting certain requirements, since it would be very