Performance and Accountability Report
Fiscal Year 2001

Farm Credit Administration

. . . we ensure a dependable source of credit for agriculture and rural America

Contents

1 Foreword
2 Statement of the Chairman and CEO
3 Farm Credit Administration Organization and Mission
- 3 The FCA Board
- 6 FCA—The Agency
- 8 Agency Officials
- 10 Farm Credit System—Its Function and Structure

13 Farm Credit System—An Overview of Existing Events and Conditions
- 13 Financial Condition of the Farm Credit System
- 16 Borrowers Served
- 17 Funding for Other Lenders
- 20 FCS Market Share of Farm Debt

23 Maintaining a Dependable Source of Credit for Farmers and Ranchers
- 23 Serving Young, Beginning, and Small Farmers and Ranchers
- 28 Helping Farmers Through USDA Loan Guarantees
- 29 Measuring the System's Safety and Soundness
- 33 Identifying Potential Threats to Safety and Soundness
- 33 Meeting Statutory Examination Requirements

35 Stress on Agriculture and the Rural Economy
40 Corporate Activity, Regulatory Guidance, and Other Agency Activities
- 40 Farm Credit System's Changing Corporate Structure
- 43 Review of the System's Continuing Structural Evolution, 1988–2001
- 46 Regulations and Bookletters
- 50 Funding Activity
- 50 Data Reporting
- 50 Litigation

51 Oversight of Farmer Mac
52 Audits, Inspections, and Investigations
53 Farm Credit Administration Performance Report
- 54 Performance Goals and Outcomes

62 Farm Credit Administration Management Systems, Controls, and Legal Compliance
- 62 Inspector General Act
- 62 Federal Managers' Financial Integrity Act
- 62 Summary of Audit Activities for FY 2001
- 63 Federal Financial Management Improvement Act
- 63 Prompt Payment Act
- 63 Civil Monetary Penalty Act
- 63 Debt Collection Act

64 Farm Credit Administration Financial Statements
- 65 Letter of Transmittal from the Inspector General
- 67 Farm Credit Administration Report of Management
- 68 About the Farm Credit Administration and its Mission
- 68 About the Financial Statements
- 69 Performance and Financial Results
- 72 Independent Auditor's Report on the Financial Statements
- 74 Independent Auditor's Report on Internal Control
- 76 Independent Auditor's Report on Compliance with Laws and Regulations
- 78 Financial Statements and Related Notes

94 Glossary
98 Building A Better Work Place . . . A Solid Foundation for the Future
100 Employees of the Farm Credit Administration
102 Additional Information

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Foreword

The *Farm Credit Administration Performance and Accountability Report for Fiscal Year 2001* consolidates the reporting requirements of the Chief Financial Officers Act of 1990, the Government Performance and Results Act of 1993 (GPRA), and several other statutes covering public accountability. Management's Discussion and Analysis of the Farm Credit Administration's (FCA or Agency) operations and financial condition, which is part of the financial statements, is on pages 3, 6 and 7, 29 through 31, 33 and 34, 52 through 63, and 68 through 71. Also included in this report is information on the financial condition and performance of the Farm Credit System. FCA examines and regulates System institutions and is responsible for ensuring their operations are safe and sound.

This report covers FCA's activities from October 1, 2000, through September 30, 2001, with mention of some subsequent events and future plans. FCA's annual Performance Report required by GPRA is presented on pages 53 through 61. It contains actual performance achieved in fiscal year (FY) 2001 compared with the performance goals set forth in FCA's Annual Performance Plan for FY 2000 and 2001.

Financial statements were prepared under standards developed by the Federal Accounting Standards Advisory Board and reporting instructions issued by the Office of Management and Budget. We are proud of achieving an unqualified audit opinion for FY 2001, the eighth consecutive year.

This report is the final step in FCA's annual planning process. The process begins when we develop the Strategic Plan, which describes FCA's strategic goals and objectives along with the level of performance we expect to achieve. Next, we develop an Annual Performance Plan, which provides detailed information about how the Agency will achieve the goals and objectives outlined in the Strategic Plan and then measure the results. Embodied in these documents are not only the principles of safety and soundness, but of customer service, product quality, effective and efficient operations, and clear communication. Finally, we prepare this report, which spells out what we have done and how well we have carried out our mission during the year, for Congress, the Office of Management and Budget, our stakeholders, and the public.

We welcome your comments on the content and presentation of this report.

They may be sent to

Office of Congressional and Public Affairs
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090

or

E-mail Address,
info-line@fca.gov

Statement of the Chairman and CEO

January 2002

My Fellow Citizens,

On behalf of my colleague Ann Jorgensen, and the men and women of the Farm Credit Administration, I invite you to review our fiscal year 2001 Performance and Accountability Report.

Our Agency is congressionally mandated to ensure a dependable source of credit for agriculture and rural America. We accomplish this mission in two important ways. First, we conduct on-site financial safety and soundness examinations of each Farm Credit System (FCS or System) institution. These examinations also focus on whether System institutions are meeting their public mandate to serve all eligible borrowers having a basis for credit.

Secondly, we approve corporate charter changes and research, develop and adopt rules, regulations and other guidelines that govern how System institutions conduct their business and interact with their customers. If, in the conduct of their business, a System institution violates a law or regulation, or does not meet safety and soundness standards, we can use our enforcement authorities to ensure the problem is corrected promptly.

The System is a nationwide network of borrower-owned financial institutions and related service organizations that provide credit to farmers, ranchers and their cooperatives in all fifty states and Puerto Rico. As the nation's oldest government sponsored enterprise, the System serves a broad public purpose by preserving liquidity and competition in rural credit markets during both good and bad economic times.

During fiscal year 2001, the System has had a solid record of performance. Capital levels have continued to increase through retained earnings and stock purchases and asset quality has remained high, even during moderate loan growth. The System has knowledgeable and experienced managers at all levels and year-over-year earnings are up. Thanks to the diligent work of the Federal Farm Credit Banks Funding Corporation, which markets debt securities sold by System banks, there was no disruption in the System's liquidity following the attacks that occurred on September 11, 2001.

We will remain ever vigilant in our efforts to ensure that the System remains financially strong and mission focused on agriculture and rural America for generations to come. We welcome your comments on ways we can continue to improve our operations and, hence, better fulfill our role and responsibility. If you have questions, comments and or concerns, please call me personally at (703) 883-4005.

All the best, always!

Michael M. Reyna
Chairman and CEO
Farm Credit Administration

Farm Credit Administration Organization and Mission

The Farm Credit Administration is an independent agency in the executive branch of the U.S. Government responsible for regulating and supervising the banks, associations, and related entities in the Farm Credit System, including the Federal Agricultural Mortgage Corporation (Farmer Mac). The FCS is a nationwide network of borrower-owned financial institutions that provide credit to farmers, ranchers, cooperatives, and rural utility cooperatives.

Created by an Executive order of President Franklin D. Roosevelt in 1933, FCA derives its powers and authorities from the Farm Credit Act of 1971, as amended (Farm Credit Act or Act). Congressional oversight of FCA and the System is provided by the U.S. Senate Committee on Agriculture, Nutrition, and Forestry and the U.S. House of Representatives Committee on Agriculture.

Our mission here at FCA is to ensure a dependable source of credit for agriculture and rural America. We do this in two specific ways. First, we conduct on-site financial examinations of Farm Credit System institutions as a way to monitor and oversee the safety and soundness of their ongoing activities. These examinations also focus on whether System institutions are meeting their public mandate to serve all eligible borrowers having a basis for credit. Secondly, we approve corporate charter changes and research, develop, and adopt rules, regulations, and other guidelines that govern how System institutions conduct their business and interact with their customers.

If a System institution violates a law or regulation, or doesn't meet safety and soundness standards, FCA may use its enforcement authorities to ensure that the problem is corrected. FCA also protects the rights of borrowers, issues or changes the charters of FCS institutions, reports to Congress on the financial condition and performance of the FCS, and approves the issuance of System debt obligations.

The Agency has its headquarters and a field office in McLean, Virginia. There are also field offices in Bloomington, Minnesota; Dallas, Texas; Denver, Colorado; and Sacramento, California.

The FCA Board

FCA policy and the regulatory agenda are established by a full-time, three-person Board, whose members are appointed by the President with the advice and consent of the U.S. Senate. They serve a six-year term and may not be reappointed after serving a full term or more than three years of a previous member's term. The President designates one member as Chairman of the Board, who serves until the end of that member's term. The Chairman also serves as FCA's chief executive officer (CEO).

Michael M. Reyna

Chairman and CEO

Michael M. Reyna was appointed to the FCA Board by President Clinton on October 22, 1998, for a term that expires May 21, 2004. He was designated Chairman by President Clinton on January 12, 2000, and as prescribed by statute, will serve as Chairman and CEO until the end of his term.

Prior to his appointment to the Board, Mr. Reyna served as director of the U.S. Department of Agriculture's (USDA) Rural Development (formerly known as Farmers Home Administration) in California from November 1993 to October 1998. In this capacity, he was responsible for growing and managing a diversified portfolio of housing, business, and infrastructure loans totaling more than $2.6 billion. He implemented a number of significant initiatives in California on behalf of the Clinton-Gore Administration, including the Northwest Economic Adjustment Initiative, the Rural Empowerment Zone-Enterprise Community program, the AmeriCorps program, and several Reinventing Government Initiatives.

Previously, Mr. Reyna served as a principal advisor to the California State Legislature for 11 years, working on financial service industry regulation and a wide range of issues, including housing, economic development, local government finance, and political reform. He was an appointed member of several local commissions, including the Sacramento City Planning Commission, for which he served as Chairman in 1993. In addition, he was a founding board member of Meadowview Community Action, a local nonprofit agency. Before his service in California, Mr. Reyna served as a private consultant to the Texas 2000 Project, an initiative of the Governor's Office of Budget and Planning. He developed and implemented a computer-based simulation model of the Texas economy, which estimated employment and population trends through the year 2000.

In 1996, Mr. Reyna received Vice President Al Gore's Hammer Award for helping to reinvent the USDA Rural Development Business and Industry Loan Guarantee Program. In 1998 and 1999, he received awards from the California Rural Builders' Council, the Rural California Housing Corporation, the California Coalition for Rural Housing, and the Valley Small Business Corporation in recognition of his leadership and commitment to rural America. He was also acknowledged by the California State Legislature for his many contributions while on staff.

Mr. Reyna holds a bachelor's degree in business administration from the University of Texas at Austin and a master's degree in public policy and administration from the LBJ School of Public Affairs at the University of Texas at Austin.

Ann Jorgensen

Board Member

Ann Jorgensen was appointed to the FCA Board by President Clinton on May 27, 1997, for a term that expires May 21, 2002. She also serves as Chairman of the Board of Directors of the Farm Credit System Insurance Corporation (FCSIC). Elected to this position in January 2000, she is the first woman to serve as Chairman. She brings to her position extensive experience in production agriculture and accounting.

In 1963, she started farming in partnership with her husband. Their farming operation now includes a cropping operation, Jorg-Anna Farms, and a hog operation, Timberland Hogs Ltd. Ms. Jorgensen also worked for 10 years as a tax accountant and for seven years as a licensed commodity broker. In 1981, she started Farm Home Offices, a mail-order catalog company that markets farm management products designed to help farmers improve their financial and production management systems.

She served on a number of governing boards for the State of Iowa, including, for six years, the Board of Regents. The Board of Regents is responsible for the State's three universities, including the University of Iowa Hospital, a world-renowned teaching hospital, and its affiliated clinics. Ms. Jorgensen is a coauthor of a producer's guide entitled *The Farmer's Guide to Total Resource Management* and is the author of a book, *Put Paperwork in Its Place*.

She was honored as the Outstanding Young Woman for the State of Iowa in 1976 and was inducted into the Iowa Volunteer Hall of Fame in 1989. Ms. Jorgensen and her husband were recognized by *Farm Futures* magazine in 1983 as the owners of one of the Top 10 Best Managed Farms. In 1997, she was one of the national agricultural leaders named by Alpha Zeta, the national honorary agricultural fraternity, to its Centennial Honor Roll. In June 2000, she was named a member of the Farm Foundation's Bennett Agricultural Round Table. The group provides a forum for discussion and dialogue among agricultural, agribusiness, government, academic, and interest group leaders on issues of importance to agriculture and rural America. She was also appointed to the International Confederation of Agricultural Credit (CICA) Central Committee in November 2001. CICA is an international organization representing agricultural credit institutions and organizations in 37 countries.

A native of Iowa, she holds a B.A. from the University of Iowa.

FCA — The Agency

FCA employs 271 people[1] in full and part-time positions. The Agency also hires summer interns at each of its offices across the country, which gives them valuable government and business experience. Together, the people of FCA work to ensure that the Farm Credit System remains a dependable source of credit for agriculture and rural America.

The FCA Board approves the policies, regulations, charters, and enforcement activities that ensure a strong Farm Credit System. The Board also provides for the examination and supervision of the FCS, including Farmer Mac, and oversees the FCS Building Association (FCSBA).

The Secretary to the Board ensures that the FCA Board complies with all public disclosure laws, coordinates a smooth flow of information to the Board members, and manages the day-to-day operations of the Office of the Board.

The Office of Chief Executive Officer enforces the rules, regulations, and orders of the FCA Board and is responsible for planning, organizing, directing, coordinating, and controlling Agency operations.

The Office of Chief Operating Officer has broad responsibility for planning, organizing, and directing a wide range of Agency functions. It manages the day-to-day operations of the Agency and serves as liaison to the FCA Board for development of regulations and Board policies. The office also supervises the development and implementation of operating plans and budgets to ensure streamlined and efficient operations.

The Office of Congressional and Public Affairs provides a wide range of information about the Agency to Congress, FCS institutions, employees, Federal agencies, the media, System borrowers, and the public. The office develops and monitors legislation pertinent to FCA and the FCS, serves as the Agency's congressional liaison, and prepares testimony for the Chairman and other Agency officials. It also manages the content of FCA's Web site and provides publication and graphic design services to the Agency.

The Office of Examination provides regulation and oversight of FCS institutions through examination, supervisory programs, and regulatory standards that promote safe and sound operations. It also ensures that FCS institutions comply with applicable laws and regulations; directs a program of examination policy formulation; and manages the Agency's enforcement activities.

The Office of General Counsel provides the FCA Board and staff with legal counsel, as well as guidance on general corporate, personnel, ethics, and administrative matters. The office supports the Agency's development and promulgation of regulations, civil litigation, enforcement of applicable laws and regulations, and implementation of conservatorships and receiverships. The office also handles Freedom of Information Act requests and matters pertaining to the Privacy Act.

The Office of Inspector General provides independent and objective oversight of Agency programs and operations through audits, inspections, investigations, and the review of proposed legislation and regulations.

The Office of Policy and Analysis develops regulations and policies that ensure the safety and soundness of the FCS. It monitors economic trends and emerging risk factors that affect the System and its customers, and collects and analyzes data from FCS institutions. The office also manages the chartering and other corporate approvals for System institutions, as well as other statutory and regulatory approval activities on behalf of the FCA Board.

1. Number of employees as of September 30, 2001.

The Office of Chief Administrative Officer oversees and administers the Agency's Human Resources Management Program. It also provides administrative services that include payroll, training, contracting and procurement, and mail, supply, and property management.

The Office of Chief Information Officer oversees all activities related to planning, managing, and administering FCA's information technology. It provides office automation software, database administration, systems development, customer assistance, and network, Web, and e-business services. The office also provides records management and library services.

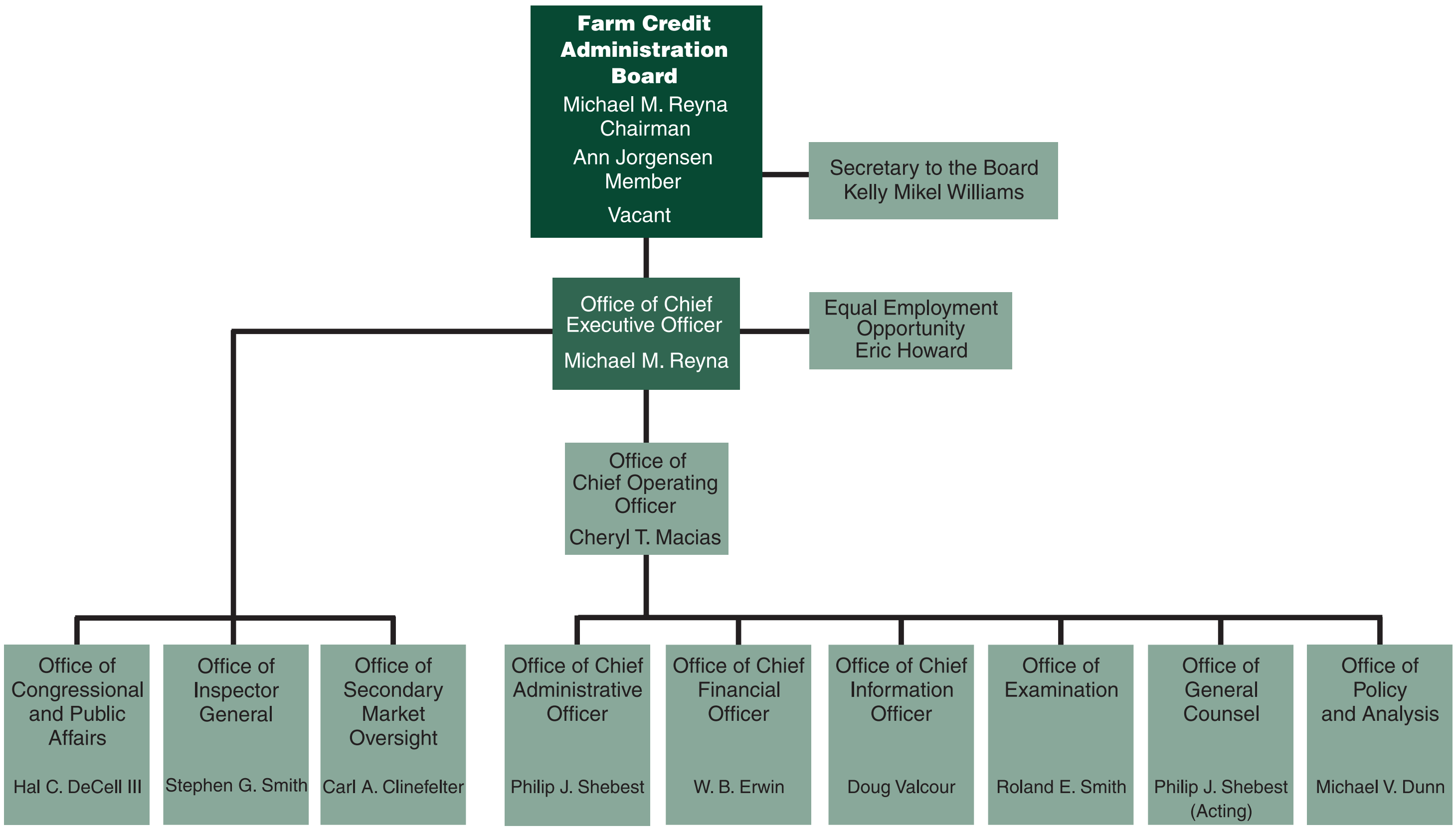
The Office of Chief Financial Officer provides financial services to the Agency and other customers, including financial systems operations, periodic financial reports, and processing payments to vendors.

The Office of Secondary Market Oversight provides for the examination and general supervision of Farmer Mac's activities to ensure safe and sound performance of its powers, functions, and duties.

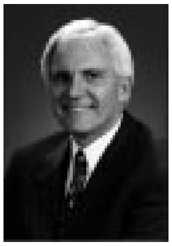
The Equal Employment Opportunity (EEO) Program is an essential part of the Agency's efforts to achieve and manage a diverse workforce, and encourage awareness of and respect for diversity in the workplace. The office works to prevent employment discrimination, handles employee discrimination complaints, and sponsors training and seminars on EEO issues.

Figure 1 shows FCA's organizational structure as of September 30, 2001.

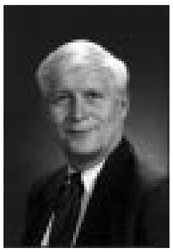
Figure 1
Farm Credit Administration
Organizational Structure
As of September 30, 2001



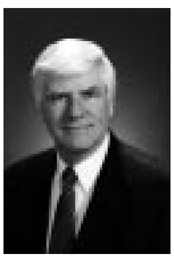
Agency Officials



Carl A. Clinefelter is Director of the Office of Secondary Market Oversight. Before assuming this position in 1998, he was Assistant Director of the Office of Policy and Analysis. Since joining FCA in 1980, Mr. Clinefelter has served as a Regional Supervisory Officer in the former Office of Supervision; as an Associate Regional Director in the former Office of Examination and Supervision; as Acting Chief of the former Enforcement Division; and as Acting Director of the then Office of Special Supervision and Corporate Affairs. Before joining FCA, he was employed by the Federal Intermediate Credit Bank of New Orleans as an Assistant Vice President.



Hal C. DeCell III was named Director of Congressional and Public Affairs in August 2000. He came to FCA from the Department of Housing and Urban Development where he had served as Assistant Secretary for Congressional and Intergovernmental Relations since 1995. Mr. DeCell came to Washington in 1976 and served on the staff of the House Committee on Veterans Affairs. The following year he joined the staff of Mississippi Congressman Jamie L. Whitten, Chairman of the House Appropriations Committee and the Agriculture Subcommittee, and served as press secretary, legislative director, chief of staff, and administrative assistant. He also served as associate staff to the House Appropriations Committee.



Michael V. Dunn[2] became Director of the Office of Policy and Analysis in January 2001 after briefly serving as a member of the FCA Board. Prior to joining FCA, he was the Under Secretary of Agriculture for Marketing and Regulatory Programs at the U.S. Department of Agriculture. Mr. Dunn also served as the Acting Under Secretary for Rural Economic and Community Development and as Administrator of the Farmers Home Administration at USDA. He has been a loan officer and vice president of the Farm Credit Banks of Omaha and has served as a member of the Professional Staff of the Senate Agriculture Committee, specializing in agricultural credit.

W. B. Erwin is the Chief Financial Officer. Before joining FCA in June 2000, he served as Assistant Chief Financial Officer for Systems for the Department of Housing and Urban Development. From 1989 to 1997, he was Director of the Office of Finance for the U.S. Patent and Trademarks Office. He has also worked for the Navy, the Treasury Department, the U.S. Government Printing Office, the Air Force, and the Social Security Administration. His private industry experience was with Caterpillar and Cummins. Mr. Erwin is a certified public accountant, certified management accountant, and a certified government financial manager.

Eric Howard is the Equal Employment Opportunity Manager. He joined FCA in 1986 as an examiner in FCA's Oklahoma City Field Office. In 1991, he became a Policy Analyst for the former Policy and Risk Analysis Division in the Office of Examination in McLean, Virginia. Mr. Howard became a Senior Policy Analyst for the Regulation and Policy Division, Office of Policy and Analysis in 1997.

Cheryl Tates Macias was named Chief Operating Officer in July 2000. Prior to joining FCA, she served as Special Assistant to the President and Associate Director of the White House Office of Presidential Personnel. From 1995 to 1999, Ms. Macias worked for the U.S. Department of Agriculture. At USDA she was director of the Office of Intergovernmental Relations, Deputy Assistant Secretary for Congressional Relations, and Acting Assistant Secretary of Congressional Relations. She was director of FCA's Office of Congressional and Public Affairs from 1993 to 1995. Ms. Macias spent 17 years on Capitol Hill, which included working as the senior member of the domestic issues staff for the House Select Committee on Hunger.

2. Michael V. Dunn was named Director, Office of Policy and Analysis, on January 12, 2001, replacing Thomas G. McKenzie who was named director of the Regulation and Policy Division.

Philip J. Shebest[3] is the Chief Administrative Officer and is serving as Acting General Counsel. He joined FCA in 1990 as a senior attorney in the Office of General Counsel. Mr. Shebest became the Director of Human and Administrative Resources in 1996 and in 2000 was selected for the Chief Administrative Officer position. Prior to joining FCA, Mr. Shebest was a senior attorney-advisor in the Chief Counsel's Office of the Drug Enforcement Administration from 1985 until 1990. From 1981 through 1984, he held the rank of Lieutenant in the Judge Advocate General Corps, U.S. Navy, and was stationed in Washington, D.C., as an appellate litigation attorney.

Roland E. Smith is Chief Examiner and Director of the Office of Examination. He joined FCA in 1979 as an examiner in the St. Louis Field Office. In 1984, he was promoted to Associate Regional Director. He also managed FCA's Oklahoma City Field Office and later the Denver Field Office before he became FCA's Chief Examiner in October 1996. Mr. Smith began his professional career with the System in 1974 as a loan officer for the Production Credit Association in Greenville, North Carolina. He later served as a loan officer/credit reviewer for the Farm Credit Banks of Columbia, South Carolina.

Stephen G. Smith[4] is the Inspector General. He joined FCA in 1981 as a technical specialist. He became an examiner in 1984 and later served as Staff Assistant for the Chief Examiner. In 1989 he was named Associate Regional Director for the Agency's Albany, New York, Field Office. He later served as Senior Staff Director for the Chief Examiner, and was then named Director of the Technical and Operations Division. In 1993 he assumed new responsibilities as Director of the Information Resources Division. He was named Chief Information Officer in 1996, directing all technology and information operations for FCA. Before joining the Agency, he worked at the North Central Jersey Farm Credit Associations.

Doug Valcour[5] is the Chief Information Officer. He joined FCA in 1988 as a computer specialist in the Office of Resources Management. In 1990, he became the Chief of the Systems Development Branch, and in 1997 was named Associate Director of the Information Resources Division and Team Leader of the Technology Team. Before joining FCA, Mr. Valcour was a computer specialist for the U.S. Department of Energy from 1986 until 1988. From 1983 until 1986, he was a computer programmer and analyst for the Veterans Administration.

Kelly Mikel Williams was named Secretary to the Board in July 2000. Before joining FCA, he served in the White House as Special Advisor to the Deputy Assistant to the President for Personnel. Prior to that he worked for the Agricultural Marketing Service at the U.S. Department of Agriculture, and served as the Confidential Assistant to the Administrator and was responsible for Farm Outreach and Small Farms issues. Before coming to the Washington D.C. area, Mr. Williams was a Legislative/Political consultant to the Speaker of the California State Assembly. His experience includes service as a police officer in California.

3. Kathleen V. Buffon served as Acting General Counsel from September 10, 2000, to August 16, 2001.
4. Eldon W. Stoehr served as Inspector General until his retirement on December 15, 2000. Elizabeth Dean served as Acting Inspector General until Stephen G. Smith was named Inspector General on January 12, 2001.
5. Doug Valcour was named Chief Information Officer (CIO) on April 15, 2001. Stephen G. Smith served as CIO until he was named Inspector General.

Farm Credit System — Its Function and Structure

The FCS is a network of borrower-owned cooperative financial institutions and related service organizations, which serves all 50 states and the Commonwealth of Puerto Rico, and is the largest single agricultural lender in the country. Created by Congress in 1916 to provide American agriculture with a dependable source of credit, it is the oldest of the Government-sponsored enterprises (GSEs).

System institutions provide credit and related services to farmers, ranchers, producers or harvesters of aquatic products, and farmer-owned cooperatives. They also make loans for agricultural processing and marketing activities; rural housing; certain farm-related businesses; agricultural, aquatic, and public utility cooperatives; and foreign and domestic entities in connection with international trade. The System raises its loan funds by selling securities in the national and international money markets with FCA approval. These securities are not guaranteed by the U.S. Government. The funds are channeled to rural America through the FCS lending institutions.

As of September 30, 2001, the System was composed of 125 banks and associations. Seven Farm Credit banks provide loan funds to 69 Agricultural Credit Association (ACA) parent organizations,[6] nine ACAs, 15 Production Credit Associations (PCAs), and 25 Federal Land Credit Associations (FLCAs). ACAs make short-, intermediate-, and long-term loans; PCAs make short- and intermediate-term loans; and FLCAs make long-term loans.

One of the banks is an Agricultural Credit Bank (ACB), which also makes loans to agricultural, aquatic, and public utility cooperatives, and other persons or organizations owned by or having transactions with such cooperatives. The ACB finances U.S. agricultural exports and provides international banking services for farmer-owned cooperatives. In addition to making loans to cooperatives, the ACB provides loan funds to four ACA parent organizations, which serve New York, New Jersey, Connecticut, Rhode Island, Maine, Massachusetts, New Hampshire, and Vermont.

In addition to the banks and associations described above, FCA examines and regulates the following three entities.

The **Federal Farm Credit Banks Funding Corporation (Funding Corporation)** markets debt securities that the banks sell to raise loan funds. The Funding Corporation is owned by the System banks.

The **Farm Credit System Financial Assistance Corporation (FAC)**, chartered in 1988, provided needed capital to the System through the sale of $1.3 billion in 15-year bonds to the capital markets and the purchase of preferred stock. This stock was issued by certain System institutions that received financial assistance as authorized by the Farm Credit System Assistance Board.

6. The ACA is the parent company with two wholly owned subsidiaries, a Production Credit Association and a Federal Land Credit Association. Although legally separated, the ACA, PCA, and FLCA operate an integrated lending business with loans made through the subsidiaries appropriate to the authority of each subsidiary. The ACA, PCA, and FLCA are jointly and severally liable on the full amount of the indebtedness to the bank under the bank's General Financing Agreement. In addition, the three associations agree to guarantee each other's debts and obligations, pledge their respective assets as security for the guarantee, and share each other's capital. The three institutions have a common board and management and a common set of shareholders. Under the Farm Credit Act, the FLCA is exempt from Federal income taxes.

Partners for Progress . . . A True Fish Tale

When it first opened in 1996, the Heartland Catfish processing plant — located between the tiny Mississippi Delta towns of Itta Bena and Schlater — created 60 jobs for local residents. Today, more than 420 people work in the processing plant, turning fresh, farm-raised catfish into high quality frozen products for the food service market. With financial backing from the Farm Credit System's First South ACA and commercial banks, Heartland is a vital partner for progress in a region of the country with an historically high unemployment rate.

Heartland is owned by Tackett Fish Farms, a family-run operation that is the largest producer in the industry. One of the top four processors in the country, Heartland prepared 50 million pounds of catfish this year, up from 16 million pounds handled in its first year.

"We have grown in order to meet our customers' needs," says Danny Walker, CEO of the company. "We have to put out a consistent, quality product," he notes. "Heartland's 100-plus lines of fish products adhere to rigid flavor guide-lines."

The company's success has meant additional growth for local catfish producers and more jobs for the region. Tackett Farms, which founded Heartland Catfish, today employs more than 150 people at its 7,500 acres of catfish farms. Heartland's expanding capacity means that even Tackett can't keep up with the growth at the plant, so outside producers supply about half the fish processed, which means more jobs for the region.

With financial backing from the Farm Credit System's First South ACA and commercial banks, Heartland is a vital partner for progress in a region of the country with an historically high unemployment rate.

A recent $15 million expansion, partly financed by First South ACA, is the largest since the plant opened. The expansion incorporates design and technological innovations that increase efficiency and speed processing time. New loading bays mean fish can be delivered at both ends of the plant and trucks can off-load 30,000 pounds of fish in 10 minutes, a sixth of the usual time. Re-designed filleting tables and larger spiral freezers ensure freshness.

The company combines high-tech equipment and a strong management style with a core business leadership team that encourages participation from all staff. Heartland's success is due in part to the commitment of the employees, many of whom participate as Group Leaders in the various sections of the plant. "Through teamwork, we have created a synergy," Walker says. "By building our operations from the ground up, we've learned the plant is one machine — one cohesive processing plant."

The **Federal Agricultural Mortgage Corporation**[7] provides a secondary market for agricultural real estate and rural housing mortgages. Farmer Mac guarantees prompt payment of principal and interest on securities representing interests in, or obligations backed by, mortgage loans secured by first liens on agricultural real estate or rural housing (the Farmer Mac I Program). It also guarantees securities backed by the "guaranteed portions" of farm ownership and operating loans, rural business and community development loans, and certain other loans guaranteed by the U.S. Department of Agriculture (the Farmer Mac II Program). Farmer Mac also purchases or commits to purchase qualified loans or securities backed by qualified loans directly from lenders through the Farmer Mac I program.

FCA also examines and regulates the following five service corporations organized under Section 4.25 of the Farm Credit Act.[8]

AgVantis, Inc. provides technology-related and other support services to the associations affiliated with the Farm Credit Bank of Wichita. AgVantis, which was chartered by FCA on August 3, 2001, is owned by the bank and its affiliated associations.

The **Farm Credit Finance Corporation of Puerto Rico** uses tax incentives offered to investors to provide low-interest funding (other than that from the Funding Corporation) to the Puerto Rico Farm Credit, ACA.

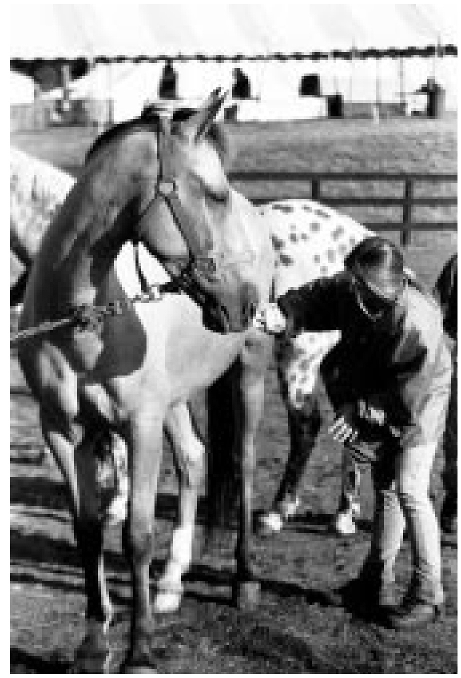
The **Farm Credit Leasing Services Corporation (Leasing Corporation)** provides equipment leasing services to eligible borrowers, including agricultural producers, cooperatives, and rural utilities. The Leasing Corporation is owned primarily by two System banks — CoBank, ACB and AgFirst Farm Credit Bank. The other banks are nonvoting stockholders.

Farm Credit Financial Partners, Inc., provides support services to the four associations affiliated with CoBank, ACB and 8 of the 15 associations affiliated with the Western Farm Credit Bank.

The **FCS Building Association** acquires, manages, and maintains facilities to house FCA's headquarters and field office staff. The FCSBA was formed in 1981 and is owned by the FCS banks. The FCA Board oversees the FCSBA's activities on behalf of its owners.

7. Farmer Mac is established in law as a part of the Farm Credit System. However, Farmer Mac has no liability for the debt of any other System institution, and the other System institutions have no liability for Farmer Mac debt. Farmer Mac is organized as an investor-owned corporation, not a member-owned cooperative. Investors in voting stock may include commercial banks, insurance companies, other financial organizations, and FCS institutions. Nonvoting stock may be owned by any investor. Farmer Mac is regulated by the FCA through the Director, Office of Secondary Market Oversight, who reports to the FCA Board for policy.
8. Section 4.25 of the Farm Credit Act provides that one or more FCS banks and/or associations may organize a service corporation to perform functions and services on their behalf. These federally chartered service corporations are prohibited from extending credit or providing insurance services.

Farm Credit System — An Overview of Existing Events and Conditions



Congress established the Farm Credit System as a Government-sponsored enterprise. The purpose was to provide a permanent, reliable source of credit and related services to agricultural and aquatic producers, their cooperatives, and related businesses in rural America. Congress intended the farmer-owned cooperative FCS to improve the income and well-being of American farmers and ranchers. It further encouraged farmer- and rancher-borrower participation in the management, control, and ownership of these cooperative institutions to help them remain focused on serving members' needs.

Eligible borrowers include all types of agricultural producers, their cooperatives, and rural homebuyers having a basis for credit. In addition, the System's lending authority extends to certain agricultural marketing and processing operations, farm-related businesses, rural utilities, and activities in support of international agricultural trade. The System serves a broad public need by preserving liquidity and competition in rural credit markets in both good and bad economic times. The accomplishment of this public goal benefits all eligible borrowers, including young and beginning farmers, small farmers, family farmers, minority farmers, women, and socially disadvantaged farmers.

FCA's regulations, policy statements, examinations, chartering activities, and other regulatory activities discussed in later chapters of this report support and facilitate the accomplishment of the System's mission by ensuring that FCS institutions operate in a safe and sound manner without undue risk to taxpayers, investors in System securities, or System borrower-stockholders.

The sections in this chapter first assess the System's financial strength and then its service to rural America. The discussion relies on commonly used measures, including trends in volume by a variety of loan types, volume of funding for non-System rural lenders and participations with other lenders, and the System's share in the marketplace. Discussion in the next chapter also covers lending activity and programs that benefit young, beginning, and small (YBS) farmers, and use of government guarantee programs in supporting loans to farmers not able to meet normal underwriting requirements.

Financial Condition of the Farm Credit System[9]

Farm Credit System loan volume increased with continued high asset quality over the 12 months ended September 30, 2001 (see Borrowers Served, page 16). Interest rates fell throughout 2001, ensuring low interest expense. Continued high levels of government payments ensured good loan repayment rates. The result of these favorable factors — high loan volume, low interest expense, and good loan repayment rates — was continued strong earnings. As a cautionary note, interest rates were near 40-year lows in late 2001 and are likely to increase. Further, government payments to agricultural producers in 2001 are expected to continue at around 40 percent of net farm income. For those grain and fiber producers who benefit from these payments, continued low commodity prices, combined with a

9. The information presented in this section includes all Farm Credit Banks and the Agricultural Credit Bank and their affiliated associations. The FCS institutions provided the data used in the overall FCS analysis to FCA or to the Federal Farm Credit Banks Funding Corporation. The analysis in this section is based on publicly available information and, except where noted, is based on the 12-month period ended September 30, 2001. See Tables 2 and 3 on pages 21 and 22, respectively, for System measures of financial condition.

significant reduction in government program payments could cause debt repayment problems and a resulting upsurge in credit quality problems at System institutions. In addition, the declining general economy may present similar problems for the many farmers with off-farm income.

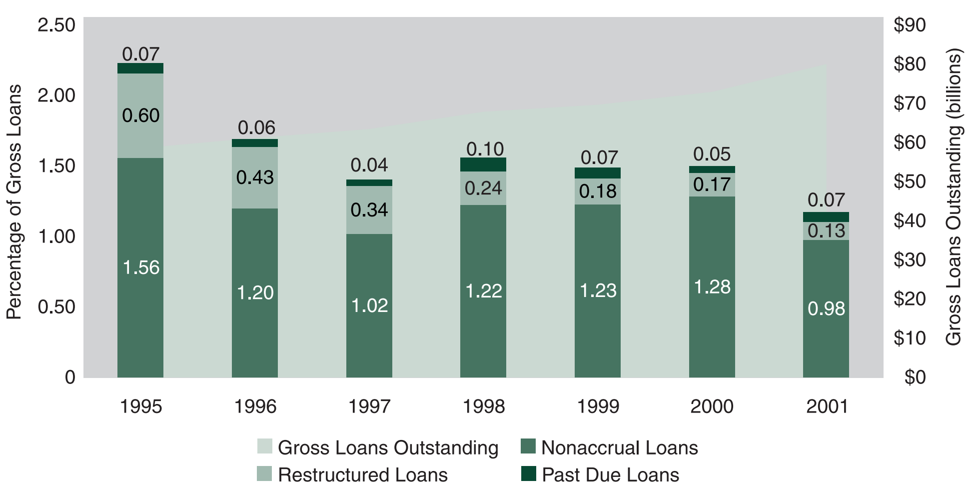
Asset Quality

Loan volume continued to grow and loan quality remained high for the year ended September 30, 2001. Gross loans increased 9.8 percent to $80.1 billion. Nonperforming loans[10] declined to 1.2 percent of total loans compared with 1.5 percent a year earlier. Nonaccrual loans were 1.0 percent of total loans compared with 1.3 percent at September 30, 2000 (see Figure 2). At September 30, 2001, the allowance for loan losses represented 216 percent of nonperforming loans and 2.54 percent of total loans compared with 179 percent and 2.68 percent a year earlier. Delinquencies (accrual loans more than 90 days past due) remained minimal.

Earnings

The System's $1.3 billion in net income for the nine months ended September 30, 2001, was up $247 million from the same period the previous year. Net interest margins were stable with a Systemwide net interest margin of 2.79 percent for the nine months ended September 30, 2001, compared with 2.74 percent for the same period in 2000. Noninterest expenses for the first nine months of 2001 were higher than for the same period in 2000, but because loan volume increased, the ratio of noninterest expenses to total loans fell slightly. Noninterest income for the first

Figure 2
Farm Credit System Nonperforming Loans Decline, 1995-2001
As of September 30



10. Nonperforming loans consist of nonaccrual loans, accruing restructured loans, and accruing loans 90 days or more past due.

Source: Federal Farm Credit Banks Funding Corporation, Quarterly Information Statement, Third Quarter.

nine months of 2001 was $281 million compared with $205 million for the same period the previous year because of increased loan fees and interest income related to tax refund claims.

The Federal Farm Credit Banks Funding Corporation reported that provisions for income taxes for the first nine months of 2001 were down $79 million from the same period in 2000, because several ACAs recognized refunds on taxes previously paid on earnings from their long-term real estate portfolios. Other ACAs expect to receive similar refunds through year-end 2001 as a result of a model settlement agreement reached with the Internal Revenue Service during the third quarter of 2000.

Capital[11]

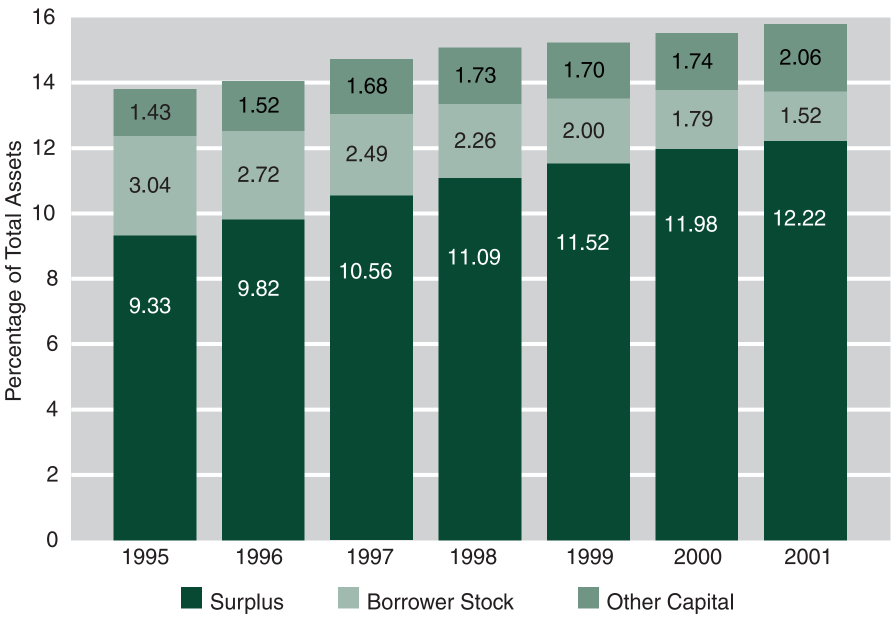
The System continues to build capital through increased earnings. Total capital ($15.7 billion) as a percentage of total assets ($99.1 billion) increased from 13.8 percent as of September 30, 1995, to 15.8 percent as of September 30, 2001 (see Figure 3). Accumulated surplus alone now represents more than 12 percent of System assets and 77 percent of total capital.

All institutions met their regulatory core surplus ratio requirement at September 30, 2001. Permanent capital ratios (PCR) at System associations ranged from a low of 10.4 percent to a high of 30.6 percent. Ninety percent of System associations had

Figure 3

Farm Credit System Capital Increases as a Percentage of Total Assets, 1995-2001

As of September 30



Source: Federal Farm Credit Banks Funding Corporation, Quarterly Information Statement, Third Quarter.

11. In addition to accumulated surplus and borrower stock, total capital includes Perpetual Preferred Stock, Restricted Capital, and Accumulated Other Comprehensive Income. It does not include Mandatorily Redeemable Term Preferred Stock or Protected Capital. One Farm Credit Bank issued $300 million in Perpetual Preferred Stock in 2001. Restricted Capital ($1.7 billion at September 30, 2001) represents the total assets under the control of the Farm Credit System Insurance Corporation, including assets that have been identified for estimated insurance obligations and the Farm Credit Insurance Fund balance. Accumulated Other Comprehensive Income ($44 million at September 30, 2001) for the System consisted mostly of unrealized holding gains and losses on available-for-sale securities. One System bank issued $225 million of Mandatorily Redeemable Term Preferred Stock. Such stock is not included in "Total Capital" though it qualifies for certain regulatory capital purposes. Protected Capital ($52 million at September 30, 2001) consists of Borrower Stock, Participation Certificates, and Allocated Equities that were outstanding as of January 6, 1988, or were issued or allocated before October 8, 1988. Protection of certain borrower capital is provided under the Farm Credit Act, which requires FCS institutions, when retiring protected borrower capital, to retire such capital at par or stated value regardless of its book value. If Mandatorily Redeemable Term Preferred Stock and Protected Capital were included in total capital, the System's capital as a percentage of total assets would be 16.1 percent as of September 30, 2001.

Table 1

Farm Credit System Gross Loans Outstanding, 1996–2001

As of September 30

Dollars in Millions

Loan Category	1996	1997	1998	1999	2000	2001	Percentage Change from 1996
Long-Term Real Estate[1]	$29,579	$30,346	$32,009	$34,218	$35,549	$39,722	34.3
Short- and Intermediate-Term[2]	15,192	16,474	18,162	18,616	18,917	21,397	40.8
Domestic Cooperatives[3]	13,414	14,053	13,768	14,549	15,908	16,298	21.5
International	2,724	2,128	2,171	2,274	2,583	2,679	(1.7)
Total	**$60,909**	**$63,001**	**$66,110**	**$69,657**	**$72,957**	**$80,096**	**31.5**

1. Includes rural home loans and various loans classified as "other."
2. Includes a portion of loans classified as "lease receivable" and various loans classified as "other."
3. Includes loans to rural utilities, rural water and waste facilities, and a portion of loans classified as "lease receivable."

Source: Federal Farm Credit Banks Funding Corporation, Quarterly Information Statement, Third Quarter.

PCRs greater than 13.2 percent. For System banks, PCRs ranged from 12.1 percent to 19.5 percent.

Borrowers Served

The System fulfills its overall mission by utilizing its authority to lend to the agricultural and rural economy. Through changes in law since the System's original authorization in 1916, System lending authorities have evolved to include

- long-term agricultural real estate loans, including rural home loans;
- short- and intermediate-term agricultural loans;
- loans to certain farmer-owned agricultural processing facilities and farm-related businesses;
- loans to farmer-owned agricultural cooperatives;
- loans that finance agricultural exports; and
- loans for rural utility cooperatives and rural water and waste facilities.

Nationwide, the System had $80.1 billion in gross loans outstanding as of September 30, 2001 (see Table 1). Agricultural producers represented by far the largest borrower group with $61.1 billion, or more than three-quarters of the total dollar amount of loans outstanding.[12] As required by law, all borrowers are also stockholder-owners of System institutions. The System has more than 430,000 stockholders; about 85 percent of these are farmers with voting stock. Based on USDA farmer numbers, about 20 percent of all U.S. farmers are stockholders of System institutions.

About half of the System's total loan volume outstanding (49.6 percent) was in long-term real estate loans, one-quarter (26.7 percent) in short- and intermediate-term loans to agricultural producers, and 20.3 percent to cooperatives. International loans (export financing) represented 3.3 percent of the System's loan portfolio. Rural home loans made up about 2.5 percent of total loans (included in long-term real estate loans in Table 1). Loans to finance rural utilities (included in cooperative loans) comprised more than $6.5 billion, or 8.1 percent, of overall loan volume; this segment has roughly doubled

12. Some of this total consists of rural home loans and leases.

over the past five years. Lease receivables (included in both the domestic cooperatives and the short- and intermediate-term categories) now account for about 2.5 percent of the overall System portfolio.

Total loan dollars outstanding have grown by $7.1 billion, or 9.8 percent, during the year ended September 30, 2001, and by $19.2 billion, or 31.5 percent, over the past five years. All loan categories grew compared with a year earlier, and all except international loans grew over the five-year period. Total members served increased about 3 percent during the past year. With lending growth occurring throughout the country, the System continues to show a strong commitment to its mission of service to agriculture even during a time when many farmers are plagued by weak farm prices.

The System's increased loan volume over the past 12 months stems mainly from long-term real estate loans (up $4.2 billion or 11.7 percent) and short- and intermediate-term loans (up $2.5 billion or 13.1 percent). Among the fastest growing components of short- and intermediate-term lending are farm-related business and marketing and processing loans. Together these lending areas made up almost half the growth in the short- and intermediate-term loan category. Other reasons for the growth have been increases in loan participations purchased from non-System lenders (up 27 percent) and increases in lease receivables (up nearly 20 percent for the Leasing Corporation). Another growth factor is the result of associations availing themselves of Farmer Mac's long-term standby purchase commitment (guarantee) program. Under this program, associations obtain a guarantee on agricultural mortgage loans by paying an annual fee to Farmer Mac. Based on the guarantee, the associations are permitted to hold less capital on the guaranteed loans and can then leverage their capital into additional growth. Together these growth areas have provided opportunities for portfolio diversification and risk reduction for System institutions.

Funding for Other Lenders

Other Financing Institutions

System banks also serve agriculture by funding and discounting short- and intermediate-term loans for non-System lending institutions, which are known as "other financing institutions" or OFIs.[13] These loans are made to eligible farmers, ranchers, aquatic producers and harvesters, farm-related businesses, and non-farm rural homeowners. Section 1.7(b) of the Farm Credit Act provides that the funding and discount services of Farm Credit banks are available, on a reasonable basis, to any OFI that is significantly involved in agricultural or aquatic lending and demonstrates a continuing need for supplemental funds to meet the needs of agricultural or aquatic borrowers. On September 30, 2001, 29 OFIs had $309 million in loans outstanding from System banks. Outstanding loans to OFIs increased by 18.8 percent in the past year, but still represent only 0.5 percent of the System's loans to producers.

In July 2001, FCA held a public meeting to seek input about various regulatory approaches that could increase the access of potential OFIs to Farm Credit bank funding. The public meeting supported the FCA Board's continuing goal of increasing availability of affordable credit to farmers and ranchers. The meeting sought to identify new methods and tools

13. OFIs include commercial banks, thrifts, credit unions, trust companies, agricultural credit corporations, and other specified agricultural lenders.

FCA Public Meeting . . . Listening and Learning

Since 1933, the Farm Credit Administration has been committed to ensuring the availability of dependable, affordable credit to agriculture and rural America. Farmers, ranchers, and their cooperatives need financing today more than ever, and FCA is working to ensure that the Farm Credit System remains a safe and sound source of credit that is able to respond to the changing needs of its customers.

In August, the FCA Board held a public meeting in Des Moines, Iowa, to hear suggestions on possible regulatory revisions to the funding and discount relationship between Farm Credit System banks and other financing institutions, which would allow System and non-System lending institutions to form partnerships to give farmers, ranchers, cooperatives, farm-related businesses, and rural utilities more flexible credit opportunities.

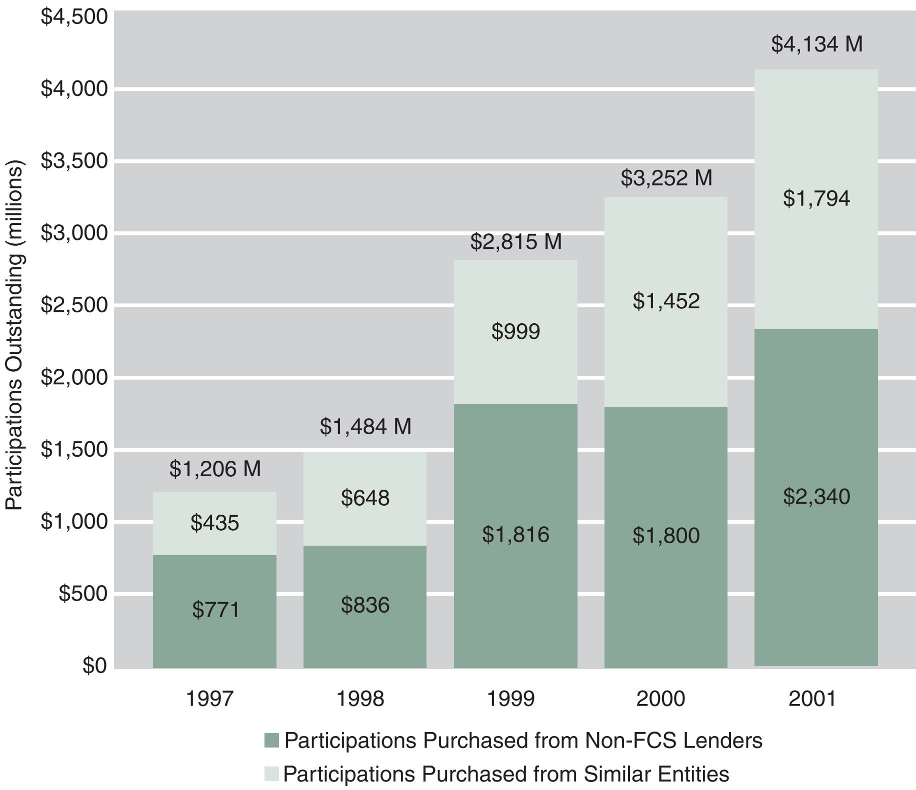
At the meeting, FCA Chairman Michael M. Reyna and Board Member Ann Jorgensen heard the voices and views of System customers, as well as bankers, commodity groups, cooperatives, FCS associations, non-System lenders, and others. While most participants underscored the need for additional funding to fill the credit gap in rural America, recommendations varied from slight modifications to extensive changes to FCA regulations. The testimony presented at the hearing is posted on the FCA's Web site at www.fca.gov.

In August, the FCA Board held a public meeting in Des Moines, Iowa, to hear suggestions on possible regulatory revisions to the funding and discount relationship between Farm Credit System banks and other financing institutions . . .

Figure 4

Farm Credit System Participations Purchased from Outside Sources Have Grown

As of September 30



Source: Call Reports received from the Farm Credit System.

to meet the credit needs of agriculture and rural America in the 21st century, and identify any regulatory barriers that may impede OFI access to FCS funding.

Participations

Another way the System provides funding to other lenders in agriculture and rural America is through loan participations. System institutions can buy and sell participations with non-FCS institutions, including commercial banks. Participation activity helps small agricultural banks facing capital constraints or high commodity concentration risks to better serve their customers. Some FCS institutions with high commodity concentrations use participations as a tool to help diversify the concentration risk inherent in their lending territory.

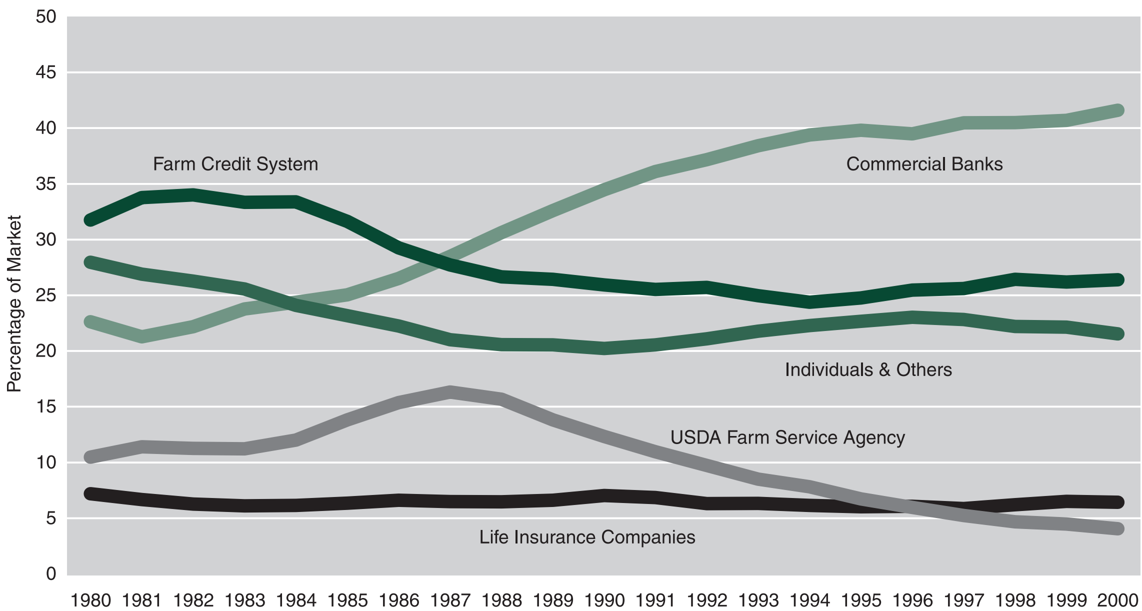
The use of participations between System and non-System lenders continues to grow as shown in Figure 4. Participations represented 5.1 percent of total loans in the System as of September 30, 2001, versus 1.9 percent five years earlier. In April 2000, FCA adopted regulations that removed out-of-territory consent for loan participations, a change that further encouraged growth in participation activity, particularly at the association level. FCS institutions reported $4.1 billion[14] in outstanding participations purchased from non-System lenders as of September 30, 2001, compared with $3.3 billion a year earlier, an increase of $882 million, or 27 percent, in the past year. This increased level of participation activity illustrates the System's use of available authorities to diversify risk in their portfolios and better serve their customers.

14. This includes $1.8 billion in participations purchased under "similar entity" authorities. Under the Farm Credit Act, an FCS bank or an association may participate, subject to certain restrictions, with a non-FCS lender in loans to a "similar entity" that is not eligible to borrow directly for purposes similar to those for which an eligible borrower could obtain financing from the participating FCS institution.

Figure 5

Total Farm Business Debt, Market Shares, 1980-2000

As of December 31



Note: "Individuals & Others" includes trade credit, seller financing of real estate, and Farmer Mac.
Source: USDA, Economic Research Service: Agricultural Income and Finance Situation and Outlook Report, AIS-77, September 2001.

FCS Market Share of Farm Debt

Reflecting its continuing service to agriculture and rural America, the Farm Credit System's year-end 2000 share of total farm debt edged higher, to 26.4 percent from 26.2 percent at year-end 1999.[15] Market share of total farm debt reached a low of 24.4 percent in 1994 and a high of 34.0 percent at year-end 1982. Over the past six years, both the System and commercial banks have had small gains in market share. Market share for Farm Service Agency (FSA) direct lending has declined, while the market share for insurance companies and individuals and others has remained stable (see Figure 5).

During 2000, the market share held by commercial banks grew somewhat faster than the System, adding nearly a full percentage point to reach 41.6 percent. Market share held by FSA and individuals and others declined slightly while insurance company market share stayed level.

As of year-end 2000, the System held 32.5 percent of the market in real estate secured farm debt, up 0.3 percent during the year. In the non-real-estate market, the System held 19.4 percent, which was unchanged from the previous year. Year-end 2001 loan volume and market share estimates were not available as this report was being compiled, but FCS information through the third quarter showed strong growth in volume of loans to farmers, suggesting the System is gaining market share in the both the long- and short-term markets in 2001.

15. Market share percentages are for farm business debt and are based on U.S. Department of Agriculture annual year-end estimates. USDA also periodically surveys debt sources used by farm cooperatives. According to the most recent survey (1997), the System provided about 54 percent of the funds borrowed by those cooperatives surveyed.

Table 2

Farm Credit System Major Financial Indicators[1]

Year to Date as of September 30

Dollars in Thousands

Farm Credit System Banks[2]	2001	2000	1999	1998	1997
Gross Loan Volume	$72,046,891	$65,967,226	$63,920,055	$60,992,400	$58,281,477
Accruing Restructured Loans[3]	$356,916	$179,596	$202,910	$280,708	$316,486
Accrual Loans 90 or More Days Past Due	$18,529	$11,539	$15,321	$35,902	$7,803
Nonaccrual Loans	$236,356	$493,983	$438,057	$469,550	$263,050
Nonperforming Loans/Total Loans[4]	0.85%	1.04%	1.03%	1.29%	1.01%
Cash and Marketable Investments	$15,266,188	$14,361,173	$13,389,314	$12,678,099	$11,428,955
Total Capital/Total Assets[5]	7.51%	7.55%	7.80%	8.38%	8.60%
Total Unallocated Retained Earnings/Total Assets	3.89%	4.01%	3.99%	4.06%	4.05%
Total Net Income	$487,314	$438,813	$379,919	$482,574	$503,160
Return on Assets[6]	0.74%	0.73%	0.66%	0.88%	0.97%
Return on Equity[6]	9.48%	9.55%	8.32%	10.32%	11.16%
Net Interest Margin	1.20%	1.21%	1.35%	1.45%	1.58%
Operating Expense Rate[7]	0.38%	0.41%	0.48%	0.46%	0.51%
Associations Excluding Federal Land Bank Associations[8]					
Gross Loan Volume	$57,482,274	$50,030,496	$42,759,760	$39,975,359	$36,330,432
Accruing Restructured Loans[3]	$86,714	$81,519	$74,164	$76,097	$76,932
Accrual Loans 90 or More Days Past Due	$36,218	$22,707	$38,502	$30,746	$20,355
Nonaccrual Loans	$545,193	$443,610	$418,474	$361,679	$383,250
Nonperforming Loans/Total Loans[4]	1.16%	1.10%	1.24%	1.17%	1.32%
Total Capital/Total Assets[5]	16.38%	16.86%	16.40%	16.12%	16.49%
Total Unallocated Retained Earnings/Total Assets	13.98%	14.03%	13.14%	12.61%	12.49%
Total Net Income	$866,296	$639,383	$485,716	$526,556	$474,647
Return on Assets[6]	1.94%	1.64%	1.44%	1.66%	1.64%
Return on Equity[6]	11.98%	9.73%	8.78%	10.29%	9.94%
Net Interest Margin	2.90%	2.98%	3.05%	3.16%	3.25%
Operating Expense Rate[7]	1.47%	1.57%	1.65%	1.63%	1.75%
Total Farm Credit System[9]					
Gross Loan Volume	$80,096,000	$72,957,000	$69,657,000	$66,110,000	$63,001,000
Accruing Restructured Loans[3]	$105,000	$123,000	$127,000	$161,000	$216,000
Accrual Loans 90 or More Days Past Due	$55,000	$34,000	$52,000	$66,000	$28,000
Nonaccrual Loans	$781,000	$937,000	$857,000	$831,000	$646,000
Nonperforming Loans/Total Loans[4]	1.17%	1.50%	1.49%	1.60%	1.41%
Total Bonds and Notes	$80,974,000	$74,369,000	$70,902,000	$67,651,000	$63,964,000
Total Capital/Total Assets[5]	16.08%	15.58%	15.30%	15.17%	14.87%
Total Surplus/Total Assets	12.22%	11.98%	11.52%	11.09%	10.56%
Total Net Income	$1,295,000	$1,048,000	$934,000	$1,008,000	$935,000
Return on Assets[6]	1.78%	1.57%	1.47%	1.68%	1.64%
Return on Equity[6]	11.26%	10.14%	9.67%	11.07%	11.16%
Net Interest Margin	2.79%	2.74%	2.75%	2.90%	2.93%

1. Some of the previously published data have been restated to include subsequent adjustments.
2. Includes Farm Credit Banks, the Bank for Cooperatives, and the Agricultural Credit Bank.
3 Excludes loans past due 90 days or more.
4. Nonperforming Loans are defined as Nonaccural Loans, Accruing Restructured Loans, and Accrual Loans 90 or More Days Past Due.
5. Total capital includes mandatorily redeemable preferred stock, protected borrower stock, and restricted capital (amount in Farm Credit Insurance Fund).
6. Income ratios are annualized.
7. Defined as operating expenses divided by average gross loans, annualized.
8. As of October 1, 2001, the FCS was composed of only direct-lender associations. All FLBAs became FLCAs or consolidated with PCAs to form ACAs by October 1, 2000.
9. Cannot be derived through summation of above categories because of intradistrict and intra-System eliminations.

Source: Call Reports received from the Farm Credit System and the Federal Farm Credit Banks Reports to Investors of the Farm Credit System.

Table 3

Farm Credit System Major Financial Indicators, By District[1]

As of September 30, 2001

Dollars in Thousands

	Total Assets	Gross Loan Volume	Nonaccrual Loans	Allowance for Loan Losses	Cash and Marketable Investments	Capital Stock	Earned Net Worth[2]	Total Net Worth[3]
Farm Credit System Banks								
Wichita	$5,522,998	$4,382,810	$4,056	$31,350	$1,030,889	$123,460	$337,247	$471,303
Texas	5,478,965	4,952,248	21,731	13,140	484,227	87,193	232,442	320,854
Western	7,544,739	6,379,384	0	5,157	1,038,194	219,042	215,333	424,764
AgriBank	21,796,501	17,302,776	52,980	159,347	4,325,520	540,610	998,840	1,554,746
AgAmerica	10,429,678	8,820,849	10,303	18,517	1,464,272	527,588	390,528	883,019
AgFirst	12,925,498	10,620,670	874	24,116	2,128,158	307,886	466,748	782,647
CoBank	24,662,809	19,588,154	146,412	324,133	4,794,928	1,341,110	812,917	2,198,854
Total	$88,361,188	$72,046,891	$236,356	$575,760	$15,266,188	$3,146,889	$3,454,055	$6,636,187
Associations								
Wichita	$4,734,177	$4,551,191	$29,651	$144,523	$18,532	$55,434	$942,296	$1,001,091
Texas	5,520,286	5,383,661	44,544	142,967	3,373	93,405	849,964	943,369
Western	7,731,044	7,366,184	93,103	138,561	6,135	84,301	1,028,531	1,112,832
AgriBank	19,285,257	18,165,164	158,403	352,259	89	157,211	2,760,478	2,919,091
AgAmerica	10,103,154	9,443,625	123,167	328,170	41,602	43,992	1,504,529	1,569,723
AgFirst	10, 715, 572	10,290,994	70,022	269,723	13,091	172,030	1,709,621	1,901,619
CoBank	2,387,699	2,281,455	26,303	65,271	11,685	38,179	408,693	455,688
Total	$60,477,189	$57,482,274	$545,193	$1,441,474	$94,507	$644,552	$9,204,112	$9,903,413
Total Farm Credit System	$99,140,000	$80,096,000	$781,000	$2,031,000	$16,022,000	$1,808,000	$12,114,000	$15,938,000

1. Aggregations of district data may not equal totals due to eliminations.
2. Excludes accumulated other comprehensive income.
3. Total Net Worth (Capital) includes capital stock and participation certificates, preferred stock, mandatorily redeemable preferred stock, protected borrower stock, earned net worth, accumulated other comprehensive income, and restricted capital or amount in Farm Credit Insurance Fund (for Farm Credit System total only).

Source: Call Reports received from the Farm Credit System and the Federal Farm Credit Banks Reports to Investors of the Farm Credit System.

Maintaining a Dependable Source of Credit for Farmers and Ranchers

As a lending cooperative that makes loans primarily in agriculture, the Farm Credit System must accept risk in order to benefit its borrower shareholders and meet its public mission. Nevertheless, for FCS institutions to maintain their presence in the marketplace as a dependable source of credit and financially related services for agricultural producers, risk levels must be properly managed and controlled. Therefore, we examine and supervise each institution according to its risk. This risk-based examination and supervisory program requires examiners to determine how existing or emerging issues facing an institution or the agricultural industry affect the nature and extent of risks in that institution. On the basis of that risk evaluation, our examiners then establish examination plans and actions.

Some risks are inherent to lending, and lending to a single industry such as agriculture is particularly risky. However, the simple existence of risk is not necessarily reason for concern. When our examiners discover unwarranted risks, they communicate with management and the board of directors to determine actions needed to mitigate or eliminate such risks. Appropriate actions for the institution may include reducing risk exposures, increasing capital, and/or strengthening risk management.

To evaluate whether an institution is meeting its public mission, our examiners determine whether the institution is operating in compliance with the laws and regulations and whether the institution is responsive to the credit needs of all types of agricultural producers having a basis for credit. As a part of that mission, direct-lender associations are obligated to establish programs that respond to the credit and related services needs of young, beginning, and small farmers and ranchers. Further, System borrowers have special rights not provided by other financial institutions. For example, if System borrowers have financial difficulties and their operations become “distressed,” they have the right to apply to restructure their loans well before a foreclosure proceeding. Accordingly, if our examiners discover that an FCS institution does not have a satisfactory YBS farmer and rancher program or has not complied with FCA Borrower Rights or other Federal consumer protection regulations, the board of that institution is required to take immediate corrective actions and provide evidence that the actions were effective.

Serving Young, Beginning, and Small Farmers and Ranchers

The Farm Credit Administration believes that providing financially sound and constructive credit and related services to borrowers identified as young, beginning, or small farmers and ranchers should be a high priority for the System. Loans to YBS borrowers help ensure a smooth transition of agribusiness to the next generation and a strong customer base for the FCS. Transitions out of and into capital-intensive farming are ongoing, but the process involves decisions compounded by the volatile nature of agricultural production and markets. Thus, lenders prudently weigh the risks and rewards of extending credit to new clients by assessing their long-term earnings potential and risk management ability. Various state and Federal programs provide interest rate breaks and/or guarantees to help lenders make the decision to extend credit to YBS farmers

and ranchers. Congress and FCA see the Farm Credit System as being in a unique position to develop YBS programs that coordinate with other governmental programs, spread risks, and take a longer-term perspective in lending to these groups.

Section 4.19 of the Farm Credit Act and FCA regulation 614.4165(b) require each System bank to report yearly on operations and achievements under programs that benefit YBS farmers and ranchers. In addition, in December 1998, the FCA Board adopted a policy statement on YBS farmers and ranchers. The policy statement emphasized the need for each association to renew its commitment to be a reliable, consistent, and constructive lender for YBS customers. To implement the policy statement, FCA also issued a Bookletter to the System that provided new definitions and reporting procedures to be fully phased in by January 1, 2001. The revisions will improve our ability to analyze and report on the System's service to all YBS borrowers. Year-to-year comparisons can be made starting in 2003, once we have two years (2001 and 2002) of data under the fully phased-in reporting requirements.[16] Because of differences in data definitions and in data collection methods, YBS data is not comparable to Census of Agriculture data.

Service to YBS farmers and ranchers has been a special focus area in the examinations of FCS institutions for the past several years, and it will continue to be one in 2002. FCA encourages all System associations to analyze their lending markets and assess their own market penetration. If this assessment suggests that an association needs to further penetrate the YBS market, we encourage the association's board to develop new programs, strengthen existing programs, or provide added incentives to contribute to the success of their marketing programs to these farmers. Thus, FCA's oversight increases awareness of the public policy mission in this area and prompts associations to provide added resources to serve this market segment. Going forward in 2002, FCA has developed a performance measure to evaluate more precisely our success in ensuring that associations maintain adequate YBS lending programs.

YBS Loans Outstanding

As of year-end 2000,[17] 16.9 percent of the number of the System's loans outstanding to farmers and ranchers were to borrowers age 35 or under (see Table 4). Borrowers with 10 or fewer years of farming experience accounted for 21.0 percent of loans. Loans to small farmers (those with annual sales under $250,000) accounted for 55.1 percent of loans.[18] The corresponding figures for the total dollar volume of loans outstanding were 12.1, 17.3, and 29.1 percent. Average loan sizes varied from $57,528 for small farmers to $89,828 for beginning farmers (averages include commitments).

YBS Loans Made

Loans and commitments made during 2000 represent current lending activity and, therefore, are a good measure of the current service to YBS borrowers. Of the total number of FCS loans made to farmers during 2000, 16.5 percent were to young farmers, 19.1 percent to beginning farmers, and 55.5 percent to small farmers (see Table 5). The corresponding percentages in terms of the dollar volume of loans made were 10.1, 14.2, and 23.6 percent. Average loan sizes were $59,386 for small farmers, $85,380 for young

16. Year-to-year comparisons cannot be made now because of the phase-in for YBS reporting. Not all institutions had fully implemented the new requirements until January 1, 2001. Once the 2002 results are available, comparisons can be made with 2001 data. Regional comparisons may remain difficult because of differences in typical-size farming operations. Also, comparisons with other lenders will not be possible because other lenders serving farmers do not report on young or beginning farm loans and use a larger definition for small farm loans.
17. System data on service to YBS farmers and ranchers are reported as of the end of the calendar year. The 2001 data will be available in April 2002.
18. The totals are not mutually exclusive and, depending on characteristics, a borrower may be counted in two or even all three categories. Also, it is not unusual for individual member-borrowers of System cooperative lending associations to be members of more than one association and to have multiple loans.

Table 4

Loans Outstanding at December 31, 2000, Benefiting Young, Beginning, and Small Farmers and Ranchers[1,2]

Loan Type	Number of Loans	Percentage of Total Number	Volume of Loans ($millions)	Percentage of Total Volume	Average Loan Size
Young Farmers and Ranchers	98,834	16.85	$7,728	12.09	$78,191
Beginning Farmers and Ranchers	123,263	21.02	$11,073	17.32	$89,828
Small Farmers and Ranchers	322,963	55.08	$18,579	29.06	$57,528
Loans to Small Borrowers by Loan Size					
$50,000 or less	206,856	62.06	$3,889	60.24	$18,803
$50,001 - $100,000	66,687	56.52	$4,686	55.47	$70,263
$100,001 - $250,000	40,117	44.26	$5,831	41.60	$145,361
More than $250,000	9,303	20.97	$4,173	11.93	$448,537

1. A young farmer is defined as 35 years old or less when the loan is made; a beginning farmer has 10 years or less farming or ranch experience; and a small farmer means the borrower typically generates less than $250,000 in annual sales of agricultural or aquatic products.
2. Full reporting under the new definitions is not required until 2001. Thus the values in the table likely understate the System's 2000 YBS activity.

Source: Annual Young, Beginning, and Small Farmer Reports submitted by each System lender through the Farm Credit banks.

Table 5

Loans Made During 2000 Benefiting Young, Beginning, and Small Farmers and Ranchers[1,2]

Loan Type	Number of Loans	Percentage of Total Number	Volume of Loans ($millions)	Percentage of Total Volume	Average Loan Size
Young Farmers and Ranchers	23,964	16.45	$2,046	10.07	$85,380
Beginning Farmers and Ranchers	27,838	19.11	$2,876	14.15	$103,324
Small Farmers and Ranchers	80,829	55.49	$4,800	23.62	$59,386
Loans to Small Borrowers by Loan Size					
$50,000 or less	54,155	67.31	$1,146	63.68	$21,153
$50,001 - $100,000	15,882	54.16	$1,181	52.78	$74,389
$100,001 - $250,000	8,536	37.67	$1,208	34.71	$141,554
More than $250,000	2,256	16.87	$1,265	9.82	$560,647

1. A young farmer is defined as 35 years old or less when the loan is made; a beginning farmer has 10 years or less farming or ranch experience; and a small farmer means the borrower typically generates less than $250,000 in annual sales of agricultural or aquatic products.
2. Full reporting under the new definitions is not required until 2001. Thus the values in the table likely understate the System's 2000 YBS activity.

Source: Annual Young, Beginning, and Small Farmer Reports submitted by each System lender through the Farm Credit banks.

A Small Farmer Who Flies High with His Feet Firmly Planted on the Ground

When he left his family's small farm in Mitchell County, Georgia, after high school and college, Captain Donnie Cochrane devoted his life to the Navy, serving as a pilot aboard aircraft carriers patrolling the Pacific Ocean, Mediterranean Sea, and Indian Ocean. A former commander of the Navy's Flight Demonstration Squadron (The Blue Angels), Cochrane has flown more than 5,350 hours and made 888 carrier landings, earning two Legion of Merit medals and three Meritorious Service medals among his many honors. But always, there was the land and the legacy that he remembered — his grandfather's farm of 250 acres off Highway 65 in Mitchell County.

When Captain Cochrane was stationed close to his family home, he saw an opportunity to meld his interests. Teaming up with his father and brother Louis, he built four modern poultry houses to raise broilers, and he chose AgFirst Farm Credit to finance the operation. "When I checked with Farm Credit, they were very familiar with poultry financing. The rates were very competitive and the patronage refund was very attractive," Donnie said. "I have been quite pleased with the professional and expeditious service I received from the staff of the Camilla branch office," said Cochrane. "In addition to being competitive, they make you feel at home and they are happy to assist in finding a solution to your financing needs."

"When I checked with Farm Credit, they were very familiar with poultry financing. The rates were very competitive and the patronage refund was very attractive."

The Cochrans raised nearly 21,500 broilers in each house, and used agricultural and management innovations to ensure a smooth operation. Experience and consistent management are vital, notes Cochrane. "You must always make sure that everything you can control, you control to the very best of your ability, always staying on top of things and using the newest and latest technology available."

Donnie uses the latest technology on the family farm as well, and recently installed an irrigation system to give the crops an advantage over dryland crops. "Irrigation is a must in this area now if you want to have a chance of making a crop. And yes, Farm Credit was willing to help me in this investment for the farm." After 23 years with the Navy, Cochrane is planning his future with his wife, Ermarvanay, and their four children. "I have a soft spot in my heart for farming," Donnie said, "and I always want to be close to the land."

farmers, and $103,324 for beginning farmers and ranchers; these loan sizes compare with an overall average loan made (including commitments) of $139,531 for the year 2000. The similarity of these percentages to those for the number and volume of loans outstanding suggests that the System has preserved its service to these important borrower groups during the recent period of unfavorable farm prices.

YBS Programs

Annually, each FCS association responds to the Agency's questionnaire on YBS programs. As of year-end 2000, the number of institutions with specific YBS goals was increasing. Compared with three years ago, the percentage of institutions with goals has doubled. As one would expect, YBS goals vary widely because of the demographics and economics of agriculture across the country. For example, one Agricultural Credit Association reported goals of 20 percent of its number of loans for young, 35 percent for beginning, and 35 percent for small farmers, while another reported goals of 15 percent, 15 percent, and 40 percent, respectively, for the same categories.

Another question asks about board oversight through periodic reporting. About 83 percent of institutions require YBS borrower loan performance to be reported to their board. Most report simply the number or the volume of YBS loans; 25 percent report on credit quality measures. Most institutions require annual reporting, although about 17 percent report at least quarterly. This is a substantial improvement since 1998 when only two-thirds of association boards had a board reporting requirement for YBS lending.

About 55 percent of System associations apply differential underwriting standards for loans to YBS borrowers or allow for exemptions. Examples include higher loan-to-market value ratios or lower debt repayment capacity standards than for other borrowers. A little more than one-third offer lower interest rates, and about 20 percent offer lower loan fees for YBS borrowers.

USDA's Farm Service Agency is the primary agency offering government-guaranteed loans for farmers, although a small portion of guaranteed loans are made through the Small Business Administration (SBA) and various state programs. A significant portion of the System's FSA guaranteed lending activity focuses on young, beginning, and disadvantaged borrowers. On average, System associations have about 57 percent of the number and 53 percent of the volume of YBS loans under government guarantee, almost all through FSA.

Associations offer a wide range of training programs or other services that benefit YBS farmers and ranchers. The most common program is training in business and financial skills; about 50 percent offer this service. About 45 percent offer leadership training. For example, one ACA provides a free executive institute for young farmers held in two sessions over a two-year period. Subjects include accounting, financial management with goals and business plans, family communication and estate planning, and economic outlook.

Other outreach activities are offered in conjunction with organizations such as state or national young farmer groups, colleges of agriculture, state or national cooperative association leadership programs, and 4-H or local chapters of the National FFA Organization (FFA). Many associations also provide financial support for scholarships, FFA, 4-H, and other agricultural organizations. In addition, most associations offer various financial services programs that assist in financial management, including estate planning, record keeping, tax planning and preparation, and farm business consulting. Sometimes associations discount or waive the cost of these services for YBS farmers and ranchers.

Helping Farmers Through USDA Loan Guarantees

Use of USDA's guaranteed loan program, run by the Farm Service Agency, has been increasing among System institutions.[19] The program gives System institutions the opportunity to reduce credit risk while making loans to borrowers who would not otherwise meet underwriting standards. The program also makes it easier for lenders to continue financing existing borrowers who may be relatively new to farming or may be facing financial hardship.

Through our examination practices and regulations, we encourage Farm Credit System lenders to obtain guarantees to reduce risk and meet the needs of the agricultural community. As discussed in a memorandum issued to all System institutions on July 10, 1998, FCA affords guaranteed loans preferential treatment in the application of risk rating systems and in the calculation of regulatory capital ratios. Normally, loans guaranteed by USDA or other U.S. Government agencies that are performing as agreed are classified as Acceptable/Performing loans. Also, even though repayment problems or other credit weaknesses may exist, examiners do not take exception if the institution maintains the loan in an accrual accounting status. Further, institutions are not required to maintain as much capital for guaranteed loans (20 percent of the balance versus 100 percent for non-guaranteed loans) when determining their regulatory capital levels.

Although System institutions take advantage of the FSA guarantee program to help a wide range of borrower types, the largest group of borrowers assisted is the System's young, beginning, and small borrowers. As noted earlier, slightly more than half the System's YBS loans carry FSA guarantees.

From September 30, 1998, to September 30, 2001, total loans outstanding to farmers with an FSA guarantee increased by $500 million to $1.495 billion, or 50 percent. The System's use of the guaranteed loan program has increased faster than overall loan growth during the same period. As of September 30, 2001, 2.5 percent of the System's loans to farmers were reported as having an FSA guarantee, compared with 2.0 percent three years earlier.[20] However, the System's share of all FSA guaranteed loans is just 19.3 percent, below the System's overall market share of farm debt.

More than 95 percent of System institutions participate in the FSA program. While use at individual associations varies widely, 22 percent of all associations (27) had FSA guaranteed volume of more than 6 percent of their total lending volume as of September 30, 2001. However, a nearly equal number had guaranteed lending volume of less than 1 percent of their

19. FSA typically guarantees 90 percent of the loan principal. Borrowers qualifying for the program must be unable to obtain sufficient credit elsewhere at reasonable rates and terms and must meet minimum cash flow requirements. Lenders must pay a 1 percent guarantee fee that can be passed on to the borrower.
20. Loans to farmers include rural housing loans (some of which are to non-farmers), marketing and processing loans, farm-related business loans, and miscellaneous loans. A small additional volume of guaranteed lending is under other Federal or state programs.

Table 6

Top 10 FCS Associations Ranked by Percentage of Number of Loans with an FSA[1] Guarantee

As of September 30, 2001

District	Association	Number of Guaranteed Loans	Total Number of Loans	Number of Guaranteed Loans as a Percentage of Total Number
Wichita	PCA of Woodward	51	295	17.3
Texas	North Alabama FLCA	180	2,056	8.8
Western	Hawaii ACA	31	380	8.2
AgFirst	Southwest Georgia ACA	177	2,390	7.4
CoBank	Yankee ACA	132	1,868	7.1
AgriBank	Northeast Wisconsin FLCA	58	832	7.0
AgriBank	North Central Wisconsin ACA	206	3,087	6.7
AgriBank	Delta ACA	10	168	6.0
Western	Idaho ACA	39	689	5.7
CoBank	First Pioneer ACA	638	11,958	5.3

1. FSA is the USDA Farm Service Agency.
Source: FCA Loan Account Reporting System (LARS).

outstanding loan volume. Tables 6, 7, and 8 show the top 10 associations that participate in the FSA program ranked in three ways: (1) number of guaranteed loans as a percentage of total number; (2) dollar value of guaranteed loans as a percentage of total loan volume; and (3) guaranteed loan dollar volume. Altogether, 22 associations are ranked in at least one of the tables. The top 10 associations in terms of dollar volume account for 39 percent of the System's FSA guaranteed loans. Almost all of these associations are FSA preferred lenders.[21]

Institutions that are heavy users of the guaranteed loan program note that guarantees reduce portfolio credit risks and are especially helpful in promoting lending to YBS borrowers. These institutions have made the extra effort to learn about the FSA guaranteed loan program and to develop procedures to participate in it. They also typically have good relationships with FSA personnel in their areas. A portion of FSA's funding for the guaranteed loan program has gone unused in recent years. This plentiful supply of funds, as well as FSA's past focus on streamlining loan guarantee procedures, may lead to increases in System use of the program in the future. With the limited use of the FSA program by many associations, the System has significant potential for expanded use of this program.

Measuring the System's Safety and Soundness

The FCA Financial Institution Rating System (FIRS) provides a general framework for collecting and evaluating all significant financial, asset quality, and management factors to assign a composite rating to each institution on a scale of 1 to 5. We evaluate the risk in each bank and direct-lender association at least every 90 days on the basis of quantitative and qualitative benchmarks to ensure that assigned ratings reflect current risk and conditions in the FCS. A 1 rating means an institution is sound in every respect. A 3 rating means an institution displays a combination of financial, management, or

21. The FSA Preferred Lender Program allows better performing lenders to make efficient use of the FSA guarantee program through reduced paperwork requirements.

Table 7

Top 10 FCS Associations Ranked by Percentage of Dollar Volume with a Farm Service Agency Guarantee

As of September 30, 2001

Dollars in Thousands

District	Association	Guaranteed Loan Volume	Total Loan Volume	Guaranteed Loan Volume as a Percentage of Total Volume
Texas	North Alabama FLCA	$42,576	$221,063	19.3
Wichita	PCA of Woodward	$3,868	$25,320	15.3
AgriBank	North Central Wisconsin ACA	$24,785	$225,840	11.0
AgFirst	Southwest Georgia ACA	$29,970	$279,672	10.7
AgriBank	Grand Forks ACA	$35,007	$337,386	10.4
AgriBank	North Dakota ACA	$26,403	$274,023	9.6
Western	Hawaii ACA	$5,935	$66,064	9.0
AgFirst	Central Kentucky ACA	$8,779	$99,749	8.8
AgriBank	Western Arkansas ACA	$39,818	$472,689	8.4
AgriBank	PCA of Northwest Wisconsin	$7,201	$91,016	7.9

Source: FCA Loan Account Reporting System (LARS).

Table 8

Top 10 FCS Associations Ranked by Dollar Volume of Loans with a Farm Service Agency Guarantee

As of September 30, 2001

Dollars in Thousands

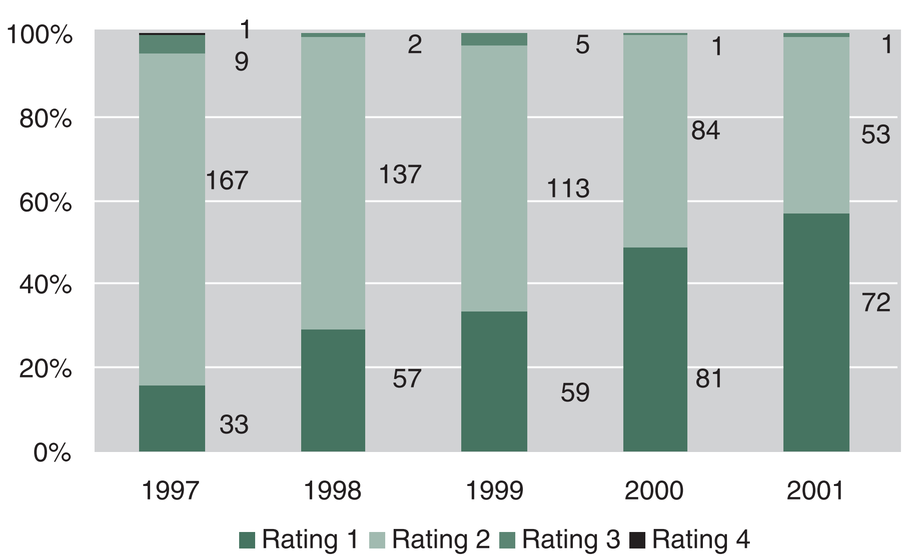
District	Association	Guaranteed Loan Volume	Total Loan Volume	Guaranteed Loan Volume as a Percentage of Total Volume
AgriBank	GreenStone ACA	$132,764	$1,686,451	7.9
CoBank	First Pioneer ACA	$87,256	$1,423,275	6.1
AgFirst	Carolina ACA	$60,536	$959,412	6.3
AgriBank	AgCountry ACA	$59,401	$815,261	7.3
AgFirst	MidAtlantic ACA	$47,882	$1,084,411	4.4
Texas	North Alabama FLCA	$42,576	$221,063	19.3
AgriBank	Mid-America ACA	$42,484	$6,049,815	0.7
AgriBank	Badgerland ACA	$42,443	$1,101,453	3.9
AgriBank	Western Arkansas ACA	$39,818	$472,689	8.4
AgriBank	Western Missouri ACA	$37,559	$484,077	7.8

Source: FCA Loan Account Reporting System (LARS).

compliance weaknesses ranging from moderately severe to unsatisfactory. A 5 rating means there is an extremely high immediate or near-term probability of failure.

Throughout FY 2001, FIRS ratings as a whole reflected the stable to improving financial conditions of FCS institutions and, as reflected in Figure 6, the overall trend in FIRS ratings continued to be overwhelmingly positive. By the end of the second quarter, there were several more 1-rated institutions (69, or 55 percent) than 2- and 3-rated institutions (56, or 45 percent). There was only one 3-rated institution, which had $19 million in total assets at September 30, 2001, which merged with another association on November 1, 2001. The strength of FCS institutions displayed by these ratings reflects a financially safe and sound Farm Credit System, which was achieved in part by government payments that allowed many borrowers to meet debt obligations during a period of low market prices for a number of commodities. The overall financial strength maintained by the System reduces the risk to investors in FCS debt, the Farm Credit System Insurance Corporation, and FCS institution stockholders.

Figure 6
Farm Credit System FIRS Composite Ratings Steadily Improve[1]
As of September 30



1. At September 30, 1998, 1999, 2000, and 2001, no institutions were 4 rated.

Note: FIRS ratings are based on capital, asset quality, management, earnings, liquidity, and sensitivity to market risk. Ratings range from 1 (a sound institution) to 5 (an institution that is likely to fail).

Source: FCA Examination Reports.

From Grape to Glass . . . An Organic Winery That Does It All

When Bill Powers, owner of Badger Mountain Wines in Kennewick, Washington, stopped using chemical fertilizers in his orchards in 1987, he wasn't looking to "grow organic."

"We were just attempting to grow without chemicals," says the owner of the first and largest Washington State-certified organic vineyard and winery. As grape prices fell in the 1980s, Bill Powers began to crush his own grapes rather than lose money selling them to his regular buyers. The bulk wine was sold to customers on the East Coast, but in 1990, Powers started making his own wine with his son, Greg, as winemaker.

The family finds natural ways to fight pests that threaten the vines. Bill and Greg discovered a tiny wasp perfect for fighting leafhoppers, but couldn't find anyone selling them, so they had to learn how to build a population naturally.

Working with Northwest Farm Credit Services has also reduced their risk, because the association focuses on serving producers and rural customers and knows the financial territory facing their customers.

"We've worked to encourage a habitat for natural predators," says Bill, "and to eliminate the habitat for pests." Their hands-on style is also evident in how they market their products. The wines are sold in distinctive blue-glass bottles that make them stand out among the hundreds of offerings in a store. And they also market their wines through a Web site.

Badger Mountain Wines also bottles and sells non-organic wines with grapes purchased from local vineyards. "We work closely with them to be sure we have the quality grapes we need. Working with them also reduces the risk. The chance of a freeze getting all the vineyards is slim," says Bill Powers. Working with Northwest Farm Credit Services has also reduced their risk, because the association focuses on serving producers and rural customers and knows the financial territory facing their customers.

Identifying Potential Threats to Safety and Soundness

In addition to quarterly FIRS reviews, we use a semiannual financial forecasting model to identify and evaluate prospective risk in institutions over the upcoming 12 to 24 months under "most likely" and "worst case" scenarios, respectively. By evaluating each institution's financial condition and performance under various scenarios, we can identify institutions with emerging risk and the potential for adverse performance. This evaluation enhances our ability to carry out our risk-based supervision program to ensure that the boards of directors of FCS institutions address and correct problems before irreparable harm occurs to an institution's financial condition. Our financial forecasting analysis, based on June 30, 2001, Uniform Call Report data, projects that the financial condition of the FCS will remain sound through June 30, 2002, and June 30, 2003, under "most likely" and "worst case" scenarios, provided government support to agriculture continues.

Other important aspects of our examination and supervisory program include a loan portfolio stress model to evaluate the potential impact of changes in interest rates and declines in borrower repayment capacity on an institution's earnings and financial condition; an analysis of new money, refinancing, and rollover trends to identify the source of growth and the potential for transfer of risk from other lenders to FCS institutions (especially during stressful times in agriculture); and a database of FCS institutions' loan underwriting standards to analyze whether boards are properly adjusting standards in response to changing risk. During FY 2001, the results of these analyses indicated that the System would remain financially sound and well positioned to meet its public mission through good and bad times.

Meeting Statutory Examination Requirements

The Farm Credit Act requires FCA to examine each FCS institution at least once during each 18-month period.[22] Nonetheless, in accordance with our risk-based examination program, we maintain the flexibility to complete examination activities at any time, as needed. Consistent with this philosophy, we have maintained a policy of examining System banks and direct-lender associations with greater than $1 billion in total assets at least once every 12 months because of these institutions' relative importance to the overall financial soundness of the System. FCA conducted 106 examinations in FY 2001, including examinations of 93 FCS direct-lender associations, six Farm Credit Banks, two service corporations, one Agricultural Credit Bank, the FCS Financial Assistance Corporation, Farmer Mac, the FCS Building Association, and the National Consumer Cooperative Bank, which is not an FCS institution.[23]

The Small Business Administration and USDA also used FCA's examination expertise in 2001. SBA contracted with FCA to conduct examinations of financial companies licensed by SBA to make guaranteed loans to small businesses. USDA contracted with FCA to conduct examinations of financial companies licensed by USDA to make guaranteed loans under USDA's Business and Industry Guaranteed Loan program. While the safety and soundness of the System remains the primary objective of FCA, we

22. Federal Land Bank Associations (FLBAs) must be examined at least once every three years. However, during 2001 the remaining FLBAs in the System became Federal Land Credit Associations, which are direct-lender institutions subject to the 18-month frequency requirement.
23. FCA is required under the provisions of Section 115 of the National Consumer Cooperative Bank (NCB) Act of 1978, as amended, to examine and report on the condition of the NCB. Since the passage of this law, FCA has conducted an annual safety and soundness examination of the NCB and issued a Report of Examination to the NCB's board.

FCA agreed to examine several non-bank lenders that participate in making loans through USDA's Business and Industry Guaranteed Loan Program. The interagency agreement between FCA and the Rural Business-Cooperative Service (RBS) was signed April 12, 2001, by Chairman Reyna (seated, left) and William F. Hagy III, RBS Acting Administrator.

believe the continuing use of FCA examination resources by SBA and USDA is a positive reflection on the expertise of FCA examiners and serves to broaden their examination skills while increasing job satisfaction and employee retention.

Differential Supervision and Enforcement

When an institution is not properly managing its risks or complying with laws and regulations, FCA's goal is to use suitable means to influence the institution's board of directors to adjust its practices. When examiners discover unsafe or unsound conditions or violations of laws or regulations, we communicate the required corrective actions to the institution's board through a Report of Examination (Report). The board then must provide FCA with a written response that addresses how the problems will be corrected, including specific time frames for correction. The number of Reports with required actions during FY 2001 comprised 28 percent of the total issued, compared with 38 percent of the Reports issued during FY 2000 and 66 percent of Reports issued during FY 1999. This declining trend in required actions correlates with the improving risk-bearing capacity of the System during that period.

We use a three-tiered supervision program (normal, special, and enforcement) to distinguish the risks and special oversight needs of institutions. Institutions under normal supervision are generally performing in a safe and sound manner and in compliance with applicable laws and regulations. These institutions have demonstrated they can correct identified weaknesses in the normal course of business. Nonetheless, our examinations may identify violations of laws or regulations or potentially unsafe or unsound practices that require corrective actions by these institutions. In addition, we regularly recommend to institution boards ways to improve the efficiency or effectiveness of their risk management processes or controls to maintain a financially sound institution. This practice of requiring corrective actions and recommending improvements to processes or controls is critical to our success in supervising regulatory compliance and the safety and soundness of FCS institutions. At fiscal year-end 2001, all FCS institutions, except one with total assets of $19 million, were under normal supervision.

For institutions displaying conditions that are serious but do not necessarily critically impair the safety and soundness of the institution, we increase the concern from normal supervision to special supervision, and our examination oversight increases accordingly. Special supervision gives the institution's board and management the opportunity to correct the problems discovered during the examination or oversight process before irreparable harm occurs to the institution. This process has been successful when the institution's board and management are both willing and able to correct the identified problems. The institution is allowed time to correct identified weaknesses before more rigorous enforcement actions by the Agency become necessary. During FY 2001, only one institution was under special supervision.

When an institution is engaging in unsafe or unsound practices or exhibits characteristics that pose excessive risk to the institution, and the board and management are unable or unwilling to correct identified weakness and violations, a formal enforcement action may be necessary. FCA uses various forms of enforcement authority to ensure that the operations of FCS institutions are safe and sound and comply with laws and regulations. This authority includes the power to enter formal agreements; issue orders to cease and desist; levy civil money penalties; and suspend or remove officers, directors, and any other persons or forbid them from engaging in FCS institutions' affairs. If the FCA Board votes to take an enforcement action, the institution performs under enforcement supervision and our examiners oversee the institution's performance to ensure compliance with the enforcement action. Throughout FY 2001, no institutions were under enforcement supervision.

Stress on Agriculture and the Rural Economy

On a national level, FCA actively monitors risks that may affect groups of Farm Credit System institutions or even the entire System. These systemic risks cover the agricultural, financial, and economic environment within which System institutions operate. Our job is not to forecast specific events, but to understand the environment well enough so that we can take steps in advance to help System institutions should adverse trends develop. Systemic risks that we will be closely watching include those discussed below.

Decline in the U.S. Economy

The economic slowdown, which began in the United States in late 2000, suddenly accelerated with the terrorist attacks on September 11, 2001. Since then, consumer confidence has declined sharply; retail sales have had the largest falloff in nine years; industrial output has had a nearly unbroken string of monthly declines since September 2000; business investment is off sharply; unemployment is climbing; jobless claims are at a nine-year high; and the Federal budget surplus has reportedly disappeared.

The U.S. economy entered into a recession during 2001 with Gross Domestic Product (GDP) expected to shrink during the last two quarters of the year. On the plus side, its appears an aggressive fiscal stimulus by Congress will combine with interest rate cuts by the Federal Reserve to stimulate growth. While growth could return to normal levels by the second or third quarter of 2002, the slump in the economy could be longer lasting. Further downside risk to the forecast would come from another serious terrorist attack on the U.S. or adverse developments in the war on terrorism.

A declining or even a slowing in the general economy has important implications for rural America and for Farm Credit System borrowers. Only 37 percent of U.S. farmers consider farming as their principal occupation, yet even these farmers (on average) rely on off-farm income for three-quarters of their total income. Rural residents with jobs tied to the travel, tourism, entertainment, and hospitality sectors have been particularly hard hit. Interest and dividend income is also declining. Since off-farm income sources are a significant source of loan repayment for many System borrowers, adverse trends in rural unemployment could lead to increased borrower financial stress.

Farm Income Up Nominally, Costs Stable

USDA estimates that net cash income from farming (includes government payments) could reach $60.8 billion in 2001, up nearly 6 percent from the previous year and 2.5 percent above the 1993 record. In real dollar terms, however, cash income in 2001 would actually be about 11 percent below the 1993 record. While livestock returns have been strong through the first half of the year, crop returns, even though up slightly, remain weak due to low crop prices and the high cost of some inputs like fertilizer. In addition, markets for higher-valued products like beef, gourmet cheeses, wines, and nursery products may soften. The outlook for 2002 could be for lower cash receipts for both crops and livestock, particularly if export markets soften because of the global economic slowdown.

Production expenses are forecast to be fairly stable in 2001, with moderately higher fertilizer and electricity costs and

only slightly higher petroleum and pesticide prices. A great deal of uncertainty currently surrounds the petroleum market. Although the general economic slowdown has reduced oil prices, this could rapidly change should the war in Afghanistan spill over into oil producing countries in the Middle East. Eleven successive interest rate cuts by the Federal Reserve since the beginning of 2001 are lowering interest expenses for rural businesses, a welcome dividend in stressful times.

Future of Government Payments Uncertain

U.S. farmers have become increasingly dependent on direct government support to supplement their weak cash flow positions over the past five years. Payments as a share of net farm income increased sharply between 1996 and 2000, rising from 13 percent to 49 percent. Direct government payments went to about 43 percent of the nation's farms in 2000. Due to somewhat higher crop prices and the scheduled reduction in production flexibility payments, government payments as a percentage of total income is expected to decline for 2001.

New farm legislation to replace the 1996 Farm Bill, which expires at the end of 2002, is currently being debated in Congress. However, prospects for continued large payments to agriculture have recently been lowered because of the effects of the economic slowdown on government revenues as well as the new budget priorities following September 11. Fundamental shifts in program options now being considered will lead to considerable uncertainty, especially for major program crop producers. For lenders, reduced payments for traditional groups could mean increased risk of borrower repayment problems and uncertainty regarding land values. Lenders will need to continue to encourage borrowers to use improved risk management strategies, including hedging, crop insurance, and other risk management tools.

Farm Real Estate Values to Hold in 2001 but Could Soften in 2002

The value of U.S. farm real estate, the largest component of farm assets (78 percent), has steadily increased by a total of 27 percent during the past five years. Significant portions of that value are increasingly attributable to two factors: direct government payments and urban influence. Farmland value depends largely on expectations for earnings from farming, government program payments, and non-farm demand. Even in areas of low farm cash receipts, record levels of government payments over the past few years have helped prop up farm real estate values as these payments are capitalized into land values. Farm commodity program payments have the highest effect on land values in the areas where program crops are grown. These areas are in the middle portions of the U.S. where government payments account for between 22 and 24 percent of the market value of farmland, according to a recent study by USDA. The declining health of the urban economy and the recreational industry will have a bigger impact on dampening farm real estate prices in areas where program crops are not grown. Good examples are California and Florida, where land prices in some areas have recently declined because of low returns for certain fruit crops.

Given the anemic outlook for the general economy over the near term and the increasing uncertainty about the future level of government payments, farmers may experience some softening in land values during 2002. If Congress were to make significant changes in the distribution pattern or in the amount of government farm payments, declines in land values could be significant in areas where program crops are grown. For the System, with 50 percent of its portfolio in real estate loans collateralized by a first lien on farmland, sudden drops in real estate values would be a concern. The related fall in farmer cash flows would accentuate the problem. Fortunately, the history of farm program changes includes multiple-year transition periods. In addition, System collateral margins are designed to protect against all but severe declines in land values.

International Trade Prospects Dim

Export markets are critical to the health of the U.S. farm sector with agricultural exports comprising more than a quarter of farm cash receipts in recent years compared with just 15 percent in the early 1970s. As the world economy recovered from the slowdown in the late 1990s, global trade and U.S. agricultural exports picked up slightly in 2000 and in 2001. Exports for FY 2001 rose 4 percent to $53 billion driven by an increase in sales of high-value products. However, a global slowing of growth, as well as fallout from the terrorist attacks of September 11, 2001, could lead to a contraction in global trade and U.S. agricultural exports for 2002.

The most serious threat to U.S. competitiveness in global commodity markets over the longer term lies in countries like Brazil and Argentina with their potential acreage and yield increases along with their weak currencies relative to the U.S. dollar. The rapid adoption of new technologies and recent infrastructure investments in these countries have positioned them to respond to any further growth in world trade. Even China has emerged as an important competitor of the United States in certain markets like corn. However, China's drive to become a member of the World Trade Organization (WTO) could open previously restricted markets for U.S. agricultural products. As exports make up a growing share of cash receipts, the incomes of farmers and ranchers are more exposed to economic and political shocks beyond U.S. borders.

Ag Terrorism

The September 11, 2001, attacks on America, followed by a series of bioterrorism incidents involving anthrax, have heightened concern about the safety of the U.S. food supply and the underlying agricultural industry. Bioterrorism, the deliberate release of toxins or infectious organisms, is a threat to agriculture, especially in its production and processing phases. As was pointed out in a January 2001 report from the Pentagon, the nation's crops and livestock could be susceptible to widespread damage by releases of viruses, such as mad cow disease, foot-and-mouth disease, crop-stunting diseases, or other pathogens.

Steps that must be taken to increase safety will be costly, will require special training at all levels in the food chain, and may require different handling and shipping methods. However, these measures are necessary to reduce the risk of a serious event affecting the safety of the food supply. Beyond the crucial food safety issue, bioterrorism could bring widespread financial losses if farmers are required to dispose of tainted crops and livestock.

Chairman Reyna (seated, right) signed, in June 2001, a recruiting partnership agreement with Dr. Antonio R. Flores, President of the Hispanic Association of Colleges and Universities (HACU).

A Farmer, A Friend, A Farm Credit Borrower

When John Ogonowski and his wife, Peggy, were asked to help with the New Entry Sustainable Farming Project in Lowell, Massachusetts, they quickly became an important part of the program's success. The couple, whose own farming operations were financed by the First Pioneer Farm Credit, ACA, were already active members of that cooperative lending association as well as founders of a local farm preservation trust.

John lent land behind their home to the Cambodian refugees in the project. The couple's farm, White Gate, became the program's first mentor farm, a training site for the immigrants to learn modern agricultural practices. He ploughed and harrowed the land and fertilized it with compost. He excavated a pond and set up an irrigation system to water the fields of the new farmers. He ordered materials and set up a greenhouse so the growers could raise seedlings. And most importantly, he taught his new neighbors the skills and the methods they needed to grow crops and manage their businesses.

John . . . a pilot for American Airlines . . . died when the plane he was piloting, Flight 11 from Boston to Los Angeles, was hijacked by terrorists on September 11 and crashed into the World Trade Center.

John often talked about how much he loved to farm his own 200-acre land, and how wonderful it was to see the 12 Cambodian families he worked with start their own farms and fulfill their own dreams. John was also a pilot for American Airlines. He died when the plane he was piloting, Flight 11 from Boston to Los Angeles, was hijacked by terrorists on September 11 and crashed into the World Trade Center's North Tower. He leaves his wife, three children, and many friends, neighbors, and fellow farmers.

The most likely scenario would be consumer avoidance of a product thought to be unhealthy, such as the concern raised by the chemical Alar, which was used to produce apples and grapes in the early 1990s. Complicating the picture for producers is the fact that Federal crop insurance is authorized only for drought, floods, and other "natural disasters as determined by the Secretary." Hence, acts of terrorism are not currently covered by policies underwritten by the Federal Crop Insurance Corporation. Producers and their lenders are, therefore, exposed to the market risks associated with terrorism and consumer reaction to such threats.

Biotechnology's Rewards and Risks

Biotechnology provides the opportunity to introduce beneficial traits into crops and livestock breeds or remove undesirable traits in order to create more nutritional products, better yields, and lower use of chemicals and energy inputs. It is a formidable tool for farmers to assist them with their mission of producing food and fiber for a growing world population. At the same time, it can potentially improve the environment and enhance biodiversity.

Despite its promises, biotechnology also raises many questions regarding production practices, market structure, food safety, financing, property rights, government regulation, and trade measures. Producers and lenders must remain vigilant about biotechnology risks, such as restricted outlets or reduced value for their biotech products as a result of consumer rejection. Farmers could also face forfeiture if they violate the terms of their agreement with seed companies, as well as be subjected to lawsuits from other farmers if their crop causes environmental contamination through cross pollination. Institutions financing these operations must ensure that farmers take the necessary steps to mitigate production and marketing risks through strict compliance with seed manufacturers' guidelines, the use of futures contracts, and the purchase of crop or peril insurance.

Corporate Activity, Regulatory Guidance, and Other Agency Activities

Farm Credit System's Changing Corporate Structure

In FY 2001, the Farm Credit System's structure continued to change dramatically as more FCS associations adopted the new corporate structure — that of an Agricultural Credit Association with wholly owned Production Credit Association and Federal Land Credit Association subsidiaries — which many associations had adopted the previous year. The ACA parent/subsidiary structure,[24] approved in 1999, is proving to be a more effective way of conducting business. The structure enables the association to use its capital more efficiently, helps diversify the loan portfolio, and can improve financial performance by reducing operating costs. The ACA with subsidiaries is now the most common structure in the FCS and accounted for 58 percent of all associations on September 30, 2001.[25] Only nine ACAs have not yet adopted the new structure and just 15 PCAs and 25 FLCAs remain in the System, having not yet set up ACAs. We anticipate most will eventually transition to the new structure.

Summary of Activity

The pace of corporate activity set in 2000 continued in 2001. In 2001, we analyzed and approved the following 69 applications compared with 59 applications processed during 2000:

- 25 consolidations of unlike associations to form ACAs, which then restructured to establish a PCA and an FLCA as wholly owned subsidiaries of the ACA;
- 20 restructurings of ACAs to establish a PCA and an FLCA as wholly owned subsidiaries of the ACA;
- 13 charter conversions of PCAs and FLCAs to ACAs with subsidiaries (associations that converted had no merger partner);
- two consolidations of ACAs with subsidiaries;
- one merger of a PCA and an FLCA into an ACA with subsidiaries;
- one merger of two PCA subsidiaries owned by an ACA;
- creation of a service corporation owned by a bank and its affiliated associations;
- two association headquarters' moves; and
- four association name changes.

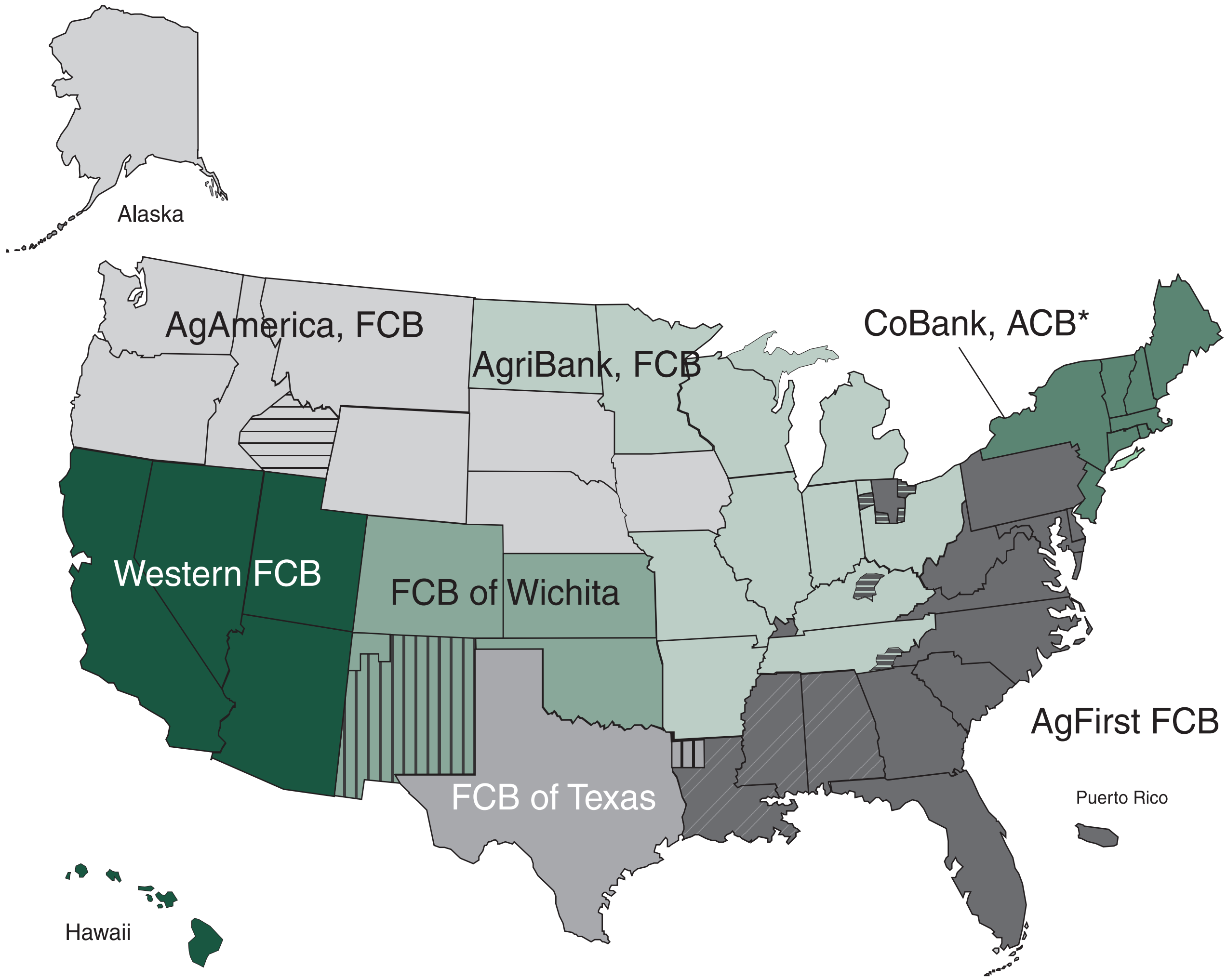
Corporate activity in 2001 resulted in a decrease in the number of associations from 158 on October 1, 2000, to 118 on September 30, 2001 — a decline of 25 percent. However, the number of ACAs increased by 33, or 73 percent, from 45 to 78 in the same period, and the number of ACAs *with subsidiaries* more than quadrupled, from 16 to 69. Figure 7 depicts the chartered territory of each FCS bank. More details about specific corporate applications in 2001 are available on FCA's Web site at www.fca.gov.

Focal Point of Corporate Activity

The new association structure — that of an ACA parent with a PCA and an FLCA as its wholly owned subsidiaries — was the preferred choice for associations that filed corporate applications last year. Under this structure, the ACA parent and its subsidiaries operate with a common board of directors and joint employees and are obligated on each other's debts and liabilities. The new ACA structure takes advantage of the tax-exempt status of the FLCA subsidiary, which provides the long-term mortgage credit. The structure also enables customers to be

24. FCA, in approving the ACA parent/subsidiary structure, views the ACA and its wholly owned operating subsidiaries as a single entity for most statutory, regulatory, and examination purposes based on their common ownership and control and cross-guarantees between and among the entities, with each entity responsible for the debts of the others and their capital and assets combined to absorb any losses.
25. As of October 1, 2000, the FCS was composed of only direct-lender associations. All Federal Land Bank Associations became FLCAs or consolidated with PCAs to form ACAs by October 1, 2000.

Figure 7
Farm Credit System Banks Chartered Territories
As of September 30, 2001



AgAmerica,FCB	Western FCB	FCB of Wichita	FCB of Texas	AgriBank, FCB	CoBank ACB	AgFirst FCB
2 ACA Parents♦	1 ACA 11 ACA Parents♦ 2 FLCAs 1 PCA	8 ACA Parents♦ 9 FLCAs 8 PCAs	11 ACA Parents♦ 10 FLCAs 2 PCAs	17 ACA Parents♦ 4 FLCAs 4 PCAs	4 ACA Parents♦	16 ACA Parents♦ 8 ACAs

The PCA of New Mexico and Ag New Mexico, Farm Credit Services, ACA are funded by the FCB of Texas. Farm Credit of New Mexico, ACA is funded by the FCB of Wichita.

The FLCAs in Alabama, Louisiana, and Mississippi are funded by the FCB of Texas.
The First South ACA is funded by AgFirst FCB.

The Northwest Louisiana PCA is funded by the FCB of Texas.

*The CoBank, ACB is headquartered in Denver, Colorado, and serves cooperatives nationwide and ACAs in the indicated area.

♦Designates ACAs that have PCA and FLCA subsidiaries.

The AG CREDIT, ACA (Ohio), Central Kentucky ACA (Kentucky), Chattanooga ACA (Tennessee), and Jackson Purchase ACA (Kentucky) are funded by the AgFirst FCB.

The Mid-America ACA, funded by AgriBank, FCB, is also authorized to lend in this territory.

The Idaho ACA is funded by the Western FCB.

stockholders of one entity — the ACA — and borrowers from either or both subsidiaries. This arrangement provides the ACA and its subsidiaries with greater flexibility for serving its customers and allows more efficient delivery of credit and services to member-borrowers.

An ACA is formed when a PCA and a Federal Land Bank Association or an FLCA consolidate and FCA issues a new charter for the resulting ACA. The new ACA parent/subsidiary structure is formed in one of three ways.

(1) An existing ACA may restructure by requesting FCA to organize and charter a subsidiary PCA and a subsidiary FLCA. Last year, 20 ACAs established subsidiaries in this manner.

(2) A PCA and an FLCA may consolidate to form an ACA yet continue their corporate identities as subsidiaries of the newly formed ACA. By September 30, 2001, 25 groups of jointly managed PCAs and FLCAs had obtained FCA's approval to consolidate and form ACAs with subsidiaries. Some consolidations involved PCAs and FLCAs whose territories were not identical. Where permitted by the Farm Credit Act, the charters we issued allowed the ACAs and their subsidiaries to offer short-, intermediate-, and long-term credit to their customers throughout the ACA's chartered territory. These charters resulted in two or more System associations having the authority to offer similar credit in some areas.

(3) A single title association[26] may ask FCA to convert its charter to an ACA. In this situation, FCA first charters a companion association — either a PCA or an FLBA — with which the single title association consolidates to form an ACA. The single title association and its companion association[27] then continue as the PCA and FLCA subsidiaries of the ACA. We allowed six PCAs and four FLCAs whose territory is also served by a new ACA to become an ACA using this approach. We also approved applications from two PCAs and one FLCA to convert their charters to ACAs even though they were not overchartered by other ACAs. These associations — without identifiable merger partners — wished to provide full-service lending (short-, intermediate-, and long-term) and related services to customers within their territory rather than be limited to a single type of lending.

FCB Activity

In August 2001, the boards of directors of the Farm Credit Bank of Wichita (FCBW), Wichita, Kansas, and Western Farm Credit Bank (WFCB), Sacramento, California, signed a letter of intent outlining how they plan to pursue a joint management agreement, which they expect will lead eventually to a merger. Currently, the WFCB and AgAmerica, FCB are jointly managed; however, they plan to terminate their joint management as soon as possible. The FCBW and the WFCB will maintain their separate corporate headquarters in Wichita and Sacramento, respectively. However, Wichita will serve as the location for the banks' combined operations.

26. Single title associations are either PCAs, authorized to provide short- and intermediate-term credit, or FLCAs, authorized to provide long-term credit. On the other hand, an ACA, operating through its PCA and FLCA subsidiaries, can offer short-, intermediate-, and long-term credit to its member-borrowers.
27. Under section 7.6 of the Act, an FLBA, upon merging with a PCA, receives the supervisory bank's direct-lending authority in the FLBA's territory. Thus, as an ACA subsidiary, the companion FLBA is chartered as an FLCA.

Review of the System's Continuing Structural Evolution, 1988–2001

The Banks

The Agricultural Credit Act of 1987 (1987 Act) sowed the seeds for the present-day restructuring of the FCS. In 1988, mandated consolidations of Federal Land Banks and Federal Intermediate Credit Banks formed Farm Credit Banks. FCA chartered FCBs in 11 of the 12 Farm Credit districts.[28]

Next, stockholders of 10 of 12 district Banks for Cooperatives (BCs) and the Central Bank for Cooperatives agreed to consolidate under one of the voluntary options in the 1987 Act to form the National Bank for Cooperatives (NBC). FCA chartered the NBC on January 1, 1989. The two remaining district BCs, in Springfield, Massachusetts, and St. Paul, Minnesota, continued as separate entities for several more years. In 1995, the two Farm Credit banks in the Springfield district — the BC and the FCB — consolidated with the NBC to form CoBank, ACB — the only Agricultural Credit Bank (ACB) in the FCS. In 1999, the St. Paul BC merged into the ACB as well.

In 1993, under terms of the 1992 Amendments, the Federal Intermediate Credit Bank of Jackson merged into The Farm Credit Bank of Columbia. From 1992 to 1995, eight more FCBs merged or consolidated, reducing their number to six. These six FCBs and the ACB are the funding banks for the 118 retail lenders that serve the member-borrowers of the FCS. The ACB is also a retail lender under Title III of the Farm Credit Act.

The Associations

Against this backdrop of bank activity, Farm Credit associations used the 1987 Act's restructuring opportunities to merge or consolidate. This activity reduced the number of associations from 377 on January 1, 1988, to 118 on September 30, 2001 — a decrease of nearly 69 percent. The 232 FLBAs that existed on January 1, 1988, either consolidated with PCAs to create ACAs or, under an option of the 1987 Act, received a transfer of long-term lending authority from their FCBs and became direct-lender FLCAs. By October 1, 2000, all FLBAs had transitioned to direct-lender associations.

The 1987 Act also required stockholders of PCAs and FLBAs that shared "substantially the same" geographic territory to vote on whether to merge the associations. These mergers, known as section 411 mergers, created the first ACAs in the FCS. Some of these mergers involved PCAs and FLBAs with "substantially the same" but not identical territory.

To carry out section 411, we adopted a policy that allowed the ACAs formed under such circumstances to have full lending authority throughout the combined territories of the merging associations. We also permitted PCAs and FLBAs (or FLCAs) whose territory was included in the charter of a section 411 ACA to convert their charters to ACAs, enabling them to compete with ACAs that operated within their territory. During 1989–1991, several associations converted their charters to ACAs, creating competition among FCS associations in some geographic areas (i.e., intra-System competition). However, after the FCA Board implemented the requirements of section 411, the only unlike association mergers

28. In May 1988, the FCA placed the Federal Land Bank of Jackson (FLBJ) in receivership. Therefore, the FLBJ was unavailable to merge with the Federal Intermediate Credit Bank of Jackson (FICBJ) under section 410 of the 1987 Act. The Farm Credit Banks Safety and Soundness Act of 1992 (1992 Amendments) required the FICBJ to merge with an FCB no later than June 30, 1993, or be required to merge with the FCB of Texas. The FCA granted a statutorily permitted one-time extension of the deadline to October 31, 1993. On October 1, 1993, the FICBJ merged into the FCB of Columbia, which is now known as AgFirst Farm Credit Bank.

allowed were of PCAs and FLBAs (or FLCAs) that shared the same territory.

As a result, the pace of consolidation and the formation of new ACAs slowed. At the same time, FLBAs and FLCAs became increasingly reluctant to surrender their tax-exempt status by consolidating to form ACAs, which are fully taxable. From 1993 to 1999, FCA chartered just one new ACA. Beginning in 1992, the number of ACAs declined as existing ACAs began to merge with one another.

Emergence of a New Association Structure

While the FCA Board recognized the dramatic changes that the System had undergone in the past quarter century, it also acknowledged the need to facilitate further evolution if System institutions were to become more efficient and competitive in the marketplace. Such an opportunity first presented itself in 1999 when an Agricultural Credit Association asked the FCA Board to approve an innovative application. The ACA asked to restructure by establishing a Federal Land Credit Association subsidiary to provide long-term credit and a Production Credit Association subsidiary to provide short- and intermediate-term credit to its member-borrowers. With stockholder approval, FCA chartered the first subsidiaries of an ACA. Under this structure, the FLCA subsidiary is exempt from Federal taxes; however, the ACA parent and its PCA subsidiary remain taxable. In FY 1999, we approved the initial application and one additional ACA restructuring request. In FY 2000, we approved seven and, in FY 2001, we approved 20.

Once the FCA Board approved the first ACA restructuring, PCAs and FLCAs (or FLBAs) that previously had decided against consolidating to form ACAs, because the ACA was taxable and/or because their chartered territories were different, began to file applications to consolidate to form ACAs with subsidiaries. In FY 1999, no associations asked to form ACAs; in 2000, we approved 3 consolidations to form ACAs; and in 2001, we approved 25 such consolidations.

Often, the ACA charters we issued included territory of adjoining PCAs and FLCAs. We gave these associations an opportunity to convert their charters to ACAs and, in the past year, 10 PCAs and FLCAs converted to ACAs as a result. In addition, two PCAs and one FLCA were unable to negotiate consolidations to form ACAs with neighboring associations. To be able to provide their customers with the one-stop, full-service advantages of the ACA parent/subsidiary structure, these associations requested that FCA convert their charters to ACAs even though no other ACAs were operating within their territory. These three requests were approved in 2001. To the extent permitted by the Farm Credit Act, all ACAs are able to offer short-, intermediate-, and long-term lending to customers throughout their entire territory.

Concluding Note

The 1987 Act provided significant opportunities for PCAs and FLBAs to improve credit delivery to their member-borrowers and new customers. Significant restructuring at both the bank and association level occurred between 1988 and 1991. Corporate activity at the association level slowed after 1991. The taxable status of the ACA and PCA versus the tax-exempt status of the FLBA and FLCA also inhibited formations of ACAs. The FCA

Michigan Turkey Producers Cooperative . . . A Legacy to Build On

In 1998, independent and contract turkey producers in Michigan faced the cancellation of their contracts with the facility that processed their birds. Worried about the future of their farms and of the nearly 200 people on their payrolls, 15 growers banded together to form the Michigan Turkey Producers Cooperative.

Despite obtaining contracts out-of-state for almost a third of their normal production, the cost of shipping the birds long distance for processing was prohibitive. The co-op members knew that to stay in business they needed a local facility to process their turkeys. They turned to financial partners, including CoBank and Greenstone Agricultural Credit Association, which are both part of the borrower-owned, cooperative Farm Credit System. With their help, the producers formed Michigan Turkey Producers, L.L.C. (MTP), and opened an innovative facility that prepares turkeys for sale to other processors.

They turned to financial partners, including CoBank and Greenstone Agricultural Credit Association, which are both part of the borrower-owned cooperative Farm Credit System.

The co-op bought and renovated a french-fry factory in Wyoming, Michigan. The eight-month renovation of the plant, which opened in March 2000, included installation of new technologies that ensure food safety and product quality. But the co-op had to start from scratch in other ways, too, says Dan Lennon, President of MTP. "We didn't just have to prepare for processing, but also had to set up accounting and information systems and hire and train a workforce."

Today the 15 original and one new co-op member have 42 farms in five counties in Michigan. Processing the turkeys keeps the plant running five days a week. Quality is important to the producers and to the companies that buy the turkey parts. "Our goal is to be the best commodity processor in the world," Lennon says, "so that quality of the MTP bird is known throughout the industry."

Board's approval of the new ACA parent/subsidiary structure in 1999 opened an avenue for associations' widespread adoption of the ACA parent/subsidiary structure as their preferred method of credit delivery in 2001.

Regulations and Bookletters

To ensure that FCS institutions comply with laws and operate in a safe and sound manner, FCA issues regulations and policy statements. We also issue Bookletters to provide guidance for the FCS. We regulate the FCS not only to ensure safety and soundness and compliance with laws, but also to ensure that the FCS efficiently carries out its statutory mission. In FY 2001, FCA amended its rules to increase opportunities for agriculture and rural America and create a more flexible regulatory environment for FCS institutions to increase their efficiency. The following activities illustrate our efforts.

National Charters

We proposed a regulation to allow FCS direct-lender associations to obtain national charters so they are less restricted by geographical boundaries in serving farmers, ranchers, and aquatic producers. The proposal provided for a local service area in which an association with a national charter must provide dependable, adequate, competitive, and constructive credit and related services to all eligible and creditworthy customers on a priority basis, consistent with safe and sound lending practices.

We believed this proposed regulation would increase credit and financial sources for agriculture and rural America. (Adopted January 11, 2001; published February 16, 2001 [66 FR 10639]) We subsequently extended the comment period on the proposed rule to April 20, 2001. (Adopted March 16, 2001; published March 21, 2001 [66 FR 15814]) At the beginning of FY 2002 (October 11, 2001), staff presented a draft final rule to the FCA Board. At the meeting, the FCA Board members, by their actions, indicated that they would not proceed with the rule and instead directed staff to begin work on a policy statement relating to the mission of the System. Staff was also directed to develop an updated regulation on business planning.

Public Meeting on OFIs and Alternative Funding Mechanisms

We held a public meeting in Des Moines, Iowa, on August 3, 2001, about the funding and discount relationship between other financing institutions and System banks. We were seeking the public's views about changes to the current regulatory framework. This meeting also addressed other partnering relationships between FCS and non-FCS financial service providers that could increase the availability of credit for agriculture and rural America.

We will use this public input in revising our OFI regulations and initiating other programs that encourage FCS and non-FCS lenders to work together to improve the flow of credit to agriculture and rural America. We began the current rulemaking on OFIs with an advance notice of proposed rulemaking that was published in the *Federal Register* on April 20, 2000 (65 FR 21121). The meeting allowed us to explore options for broadening our approach to FCS institutions' alliances with other agricultural lenders. (Public meeting announcements published

in the *Federal Register* on July 5, 2001 [66 FR 35428] and July 16, 2001 [66 FR 37681])

Stock Issuances

We issued a final rule that allows FCS service corporations to sell stock to non-FCS entities but requires adequate disclosure to investors. The rule allows an association to issue unlimited amounts of stock to its funding bank in exchange for capital the association, in turn, may distribute to its borrowers. The rule gives FCS institutions more opportunities to serve their borrowers' needs through service corporations and more efficient issuance of equities related to earnings distributions and transfers of capital. (Adopted March 8, 2001; published March 28, 2001 [66 FR 16841]; effective May 14, 2001)

Electronic Commerce

We proposed regulations reflecting emerging business approaches to electronic commerce (e-commerce). The proposed rules are designed to remove regulatory barriers to e-commerce and create a flexible regulatory environment that facilitates the safe and sound use of new technologies by FCS institutions and their customers. (Adopted September 13, 2001; published October 22, 2001 [66 FR 53348]; comment period ended November 21, 2001)

Termination of Farm Credit Status

We reproposed regulations to allow an FCS institution to terminate its FCS charter and become a financial institution under another Federal or state chartering authority. The proposal would amend the existing regulations so they apply to all FCS banks and associations. In addition, the rule would ensure that (1) all equity holders of a terminating institution are treated fairly and equitably and (2) remaining FCS institutions are able to operate safely and soundly and fulfill their statutory mandate to serve the credit needs of farmers, ranchers, and cooperatives. This rule benefits System institution shareholders who believe a change is needed in their institution's structure while ensuring that an exit fee is paid to the Farm Credit Insurance Fund in accordance with the law. (Adopted July 12, 2001; published August 20, 2001 [66 FR 43536]; comment period ended October 19, 2001)

Farmer Mac Risk-Based Capital

We issued a final rule that established risk-based capital regulations for Farmer Mac, including definitions, methods, parameters, and guidelines for developing and implementing the risk-based capital stress test. The final rule also specifies capital calculation, reporting, and compliance requirements and describes our monitoring, examination, supervisory, and enforcement activities with respect to

Farmer Mac's compliance. Finally, the rule prescribes certain requirements for business and capital planning. This rule is designed to help to ensure that Farmer Mac is able to maintain solvency even during a period of severe credit and economic risk in agriculture. (Adopted February 21, 2001; published April 12, 2001 [66 FR 19048]; effective May 23, 2001)

Loans to Designated Parties

We reproposed regulations governing the approval of loans to "designated parties," those FCS "insiders" most likely to have a conflict of interest and FCA and FCSIC employees who are authorized to borrow from the System. The reproposed rule would require an FCS institution's board, or its delegated committee, to approve all loans to a designated party that exceed the greater of $150,000 or 0.5 percent of permanent capital (not to exceed $250,000). The rule would also eliminate the System banks' approval requirement and include an option allowing an association to enter into an agreement with its affiliated bank to permit the bank to perform the designated-party loan approval. These amendments provide flexibility for System institutions to manage loan approvals appropriately but ensure proper internal controls on loans to designated parties. (Adopted August 9, 2001; published September 18, 2001, [66 FR 48098]; comment period ended October 18, 2001)

Disclosures to Shareholders

We issued a final rule providing that an FCS bank need not distribute its annual report to shareholders of its related associations unless it experiences a "significant event." The rule also requires all associations to disclose, in a separate section of their annual report, specified information about their financial and supervisory relationship with their funding bank. This final rule benefits FCS banks, associations, and their shareholders because banks and associations may reduce the cost of sharing necessary information with shareholders. (Adopted February 21, 2001; published March 12, 2001 [66 FR 14299]; effective April 27, 2001)

Capital Treatment of FCS Financial Assistance Corporation Debt Expense Bookletter

We provided guidance on the risk-based capital treatment of Farm Credit System Financial Assistance Corporation debt expense. The Bookletter specifies the Treasury repayment date under section 6.26(c)(5)(G) of the Farm Credit Act and provides guidance on the treatment of payments to the FAC for regulatory capital. This guidance helped System institutions plan for expenses and capital needs. (Dated June 27, 2001)

Eligibility

As a result of a January 19, 1999, decision of the U.S. Court of Appeals for the District of Columbia Circuit, we issued a direct final rule amending two regulations that govern eligibility and scope of financing for farm-related service businesses and nonfarm rural homeowners. In accordance with the court's decision, System banks and associations that extend long-term mortgage credit will be able to finance only necessary capital structures, equipment, and initial working capital for eligible farm-related service businesses. In addition, the revised rule allows System banks and associations to finance only homes that people who live in rural areas own and occupy as their principal

Maintaining Stability . . . The Funding Corporation Keeps Working

The September 11, 2001 terrorist attack on the World Trade Center and the resulting massive destruction in the financial district of New York City significantly disrupted the financial markets. Many brokers and dealers that sell Farm Credit System securities were shut down.

Despite the damage to buildings and disruption of communication systems that were almost beyond imagination, the Federal Farm Credit Banks Funding Corporation remained open for business. On the day of and the days following the attack, the Farm Credit System's fiscal agent was able to sell billions of dollars in securities and successfully continue operations.

In recognition of this extraordinary accomplishment, the FCA Board adopted a resolution praising the Funding Corporation's management and employees for their work in keeping the funding pipelines open throughout this unprecedented test of our nation's financial systems. The FCA Board noted that throughout the ordeal, the Funding Corporation staff worked tirelessly and diligently to maintain an uninterrupted flow of funds to farmers, ranchers, and rural America.

The FCA Board adopted a resolution praising the Funding Corporation's management and employees for their work in keeping the funding pipelines open throughout this unprecedented test of our nation's financial systems.

residences. (Adopted May 10, 2001; published May 24, 2001 [66 FR 28641]; effective July 12, 2001)

Funding Activity

The FCS raises funds for loans through the sale of debt securities, channeling funds from capital market investors to agriculture and rural communities by bringing resources from Wall Street to Main Street. Systemwide debt securities are issued as discount notes, master notes, bonds, designated bonds, or global debt securities.

As required by the Farm Credit Act, the System must obtain FCA approval for all funding requests. For the 12 months ended September 30, 2001, the FCS issued $521.8 billion in debt, up significantly from the $361.6 billion issued during the same period in 2000, owing to the increase in short-term discount note issuance.

Data Reporting

We continued to make significant strides in data management by using new technology to become more effective, more efficient, and more transparent. This year we initiated a new Internet service that gives the public easy access to certain financial information about FCS institutions. The information currently available includes the Uniform Call Report schedules and the Uniform Performance Report.[29] Previously, the public could obtain this information only by submitting a Freedom of Information Act request to FCA. The public now can view or download the information at no cost from the FCA Web site. FCA plans to add additional reports and data to its Web site in FY 2002.

Litigation

Louisiana Federal Land Bank Association, FLCA et al. v. FCA

On June 30, 2000, the Farm Credit Bank of Texas and its affiliated Federal Land Credit Associations in Alabama, Mississippi, and Louisiana filed a Complaint for Declaratory Relief against FCA. The lawsuit in the U.S. District Court for the District of Columbia challenged our final rule deleting the consent requirements for out-of-territory loan participations. On August 22, 2001, the U.S. District Court ruled against the plaintiffs' claims by granting summary judgment in our favor on each count of the complaint. The court stated, "[t]he FCA is responsible for the well-being of American farmers and their efficient access to credit. If, in FCA's judgment, this regulation provides the best possibility for achieving those goals, the court should not second-guess such policy decisions." On October 9, 2001, the plaintiffs filed an appeal to the U.S. Court of Appeals for the District of Columbia Circuit.

29. The Uniform Call Report consists of a Statement of Condition, Statement of Income, and supporting schedules. FCA collects the data quarterly from all active Farm Credit institutions. The Uniform Performance Report presents information from a selected Farm Credit institution's financial statement, including a condensed balance sheet and income statement as well as information on capital, assets, earnings and profitability, and liquidity.

Oversight of Farmer Mac

Farmer Mac is regulated by FCA through its Office of Secondary Market Oversight (OSMO), which was established in 1992, as required by Public Law 102-237. The statute prescribes that OSMO be a separate office, reporting to the FCA Board, and that its activities, to the extent practicable, be carried out by individuals not responsible for the supervision of the banks and associations of the FCS.

In FY 2001, OSMO presented for the FCA Board's consideration a final Farmer Mac risk-based capital rule. Approved by the FCA Board on February 21, 2001, the final rule became effective on May 23, 2001. However, because of a one-year period to allow for the rule's orderly implementation, Farmer Mac will not be required to comply with all aspects of the rule until May 23, 2002. OSMO also provided for the annual examination of Farmer Mac conducted as of June 30, 2001, and the ongoing monitoring of its operations and condition throughout the year.

Farmer Mac conducts its business through two programs — Farmer Mac I and Farmer Mac II. Under the former, Farmer Mac purchases, or commits to purchase, qualified loans that are not guaranteed by any instrumentality or agency of the U.S., or obligations backed by qualified loans. Under the latter, Farmer Mac purchases the guaranteed portions of farm ownership and farm operating loans, rural business and community development loans, and certain other loans guaranteed by USDA.

At September 30, 2001, Farmer Mac's net worth was $129.7 million, and its core capital remained above the minimum prescribed by section 8.33 of the Farm Credit Act. For the nine-month period ended September 30, 2001, net income was $10.8 million, up $3.2 million from the same period in 2000. Net income continued the increasing trend begun when the Farm Credit System Reform Act of 1996 (1996 Act) was signed into law on February 10, 1996. This legislation made positive revisions to Farmer Mac's operating authorities.

Farmer Mac's on- and off-balance-sheet program activity continued to increase, reaching just over $4 billion at September 30, 2001, up $1.05 billion from a year earlier. Farmer Mac's ability to achieve this growth and its statutory mission was enhanced by the new operating authorities under the 1996 Act.

At September 30, 2001, Farmer Mac I loans purchased or guaranteed after the enactment of the 1996 changes to Farmer Mac's statutory charter (post-1996 Act loans) that were 90 days or more past due, in foreclosure, or in bankruptcy represented 2.16 percent of the principal amount of all post-1996 Act loans, compared with 1.80 percent at September 30, 2000. (Farmer Mac assumes 100 percent of the credit risk on post-1996 Act loans; pre-1996 Act loans are supported by at least a 10 percent subordinated interest that mitigates credit risk.) Higher delinquency rates are likely during the first and third quarters of each year, as most Farmer Mac loans are paid semiannually.

At September 30, 2001, 97 percent of all post-1996 Act loans that were 90 days or more past due, in foreclosure, or in bankruptcy had an original loan-to-value (LTV) ratio of 70 percent or less. No such loans had an original LTV in excess of 80 percent, and the weighted average original LTV for all post-1996 Act loans was 49.4 percent. At September 30, 2001, Farmer Mac's reserve for losses totaled $14.7 million, compared with $10.0 million at September 30, 2000.

Audits, Inspections, and Investigations

During FY 2001, the Office of Inspector General (OIG) completed its first annual review under the Government Information Security Reform Act. OIG contracted with Clifton Gunderson LLP to perform the review. There were no material weaknesses in the information security at FCA. The review was submitted to the Office of Management and Budget along with FCA's own assessment of information security.

OIG also completed an audit on performance budgeting. The objective was to evaluate whether the FCA Board receives appropriate analysis and insight about FCA offices' requests for funds so it can make informed decisions. OIG and management agreed on 14 actions to improve FCA's efficiency and effectiveness in performance budgeting.

OIG contracted with the independent accounting firm Harper, Rains, Stokes & Knight, P.A., to audit the financial statements for the fiscal year ended September 30, 2001. The report was issued December 7, 2001. FCA earned an unqualified opinion.

OIG issued two inspection reports of the Office of Examination — Special Examination and Supervision Division and the Office of the Chief Examiner. OIG also issued an inspection report on the Affirmative Employment Program Action Plan.

OIG publishes summaries of audit reports and inspections in its Semiannual Report to the Congress. Copies of semiannual reports may be obtained from FCA's Office of Congressional and Public Affairs, 1501 Farm Credit Drive, McLean, VA 22102-5090, phone, 703-883-4056, fax, 703-790-3260, e-mail, info-line@fca.gov, or from FCA's Web site at www.fca.gov. OIG audit and inspection reports may also be accessed through the Office of Inspector General at www.fca.gov/oig or by e-mail at IGinformation@fca.gov.

OIG manages a continuing survey of FCS institutions. The survey provides the FCA Board with feedback about FCA's performance during examination and enforcement activities. A report of the results is issued each year. During FY 2001, OIG mailed 105 surveys and received 59 responses. Overall, the average rating for the questions answered this fiscal year was 1.68 on a scale of 1 to 5, with 1 meaning completely agree and 5 meaning completely disagree.

OIG investigations focus on violations of law or misconduct by FCA employees and contractors, as well as allegations of irregularities or abuse in FCA programs and operations. Two investigations were open at the beginning of FY 2001; one was closed during the year and one remained open as of September 30, 2001. Prosecution was declined for one criminal referral made to the U.S. Attorney's Office, and the matter was handled administratively.

The OIG Hotline (1-800-437-7322 or 703-883-4316 in the Washington, D.C., metropolitan area) and the e-mail Hotline (fca-ig-hotline@starpower.net) are the primary vehicles for FCA employees and the public to report fraud, waste, abuse, and mismanagement. All Hotline contacts are carefully evaluated, investigated, or referred, as warranted.

Farm Credit Administration Performance Report

As the independent regulator of the Farm Credit System, the Farm Credit Administration is responsible for protecting the public interest by ensuring the safety and soundness of the FCS. FCA regulations and policies must be sound and constructive, use a proactive approach, manage risks within reasonable costs, and reflect the continuing changes in, and the needs of, agriculture. We are committed to providing a flexible regulatory environment that recognizes market forces and enables the System to meet agriculture's and rural America's changing demands for credit and other related services within the authorities established by Congress. In so doing, our primary focus is to ensure the safety and soundness of the FCS.

This commitment is captured in FCA's mission statement.

The Farm Credit Administration will promote a safe and sound, competitive Farm Credit System to finance agriculture and rural America as authorized by Congress.

The Agency performs two basic functions to fulfill its mission:

- issuing regulations, approving corporate restructuring, and issuing other public policy; and
- identifying risk and taking corrective action.

To measure how effectively the Agency is fulfilling its mission, the FCA Board and senior management identified two key outcomes:

- effective regulation and public policy and
- effective risk identification and corrective action.

To achieve our desired outcomes, the Board adopted two strategic goals for FY 2000–2005.

1. Ensure the Farm Credit System fulfills its public mission to provide constructive, competitive, and dependable credit and related services for agriculture and rural America.
2. Supervise risk to ensure the safety and soundness of the Farm Credit System for the benefit of stakeholders.

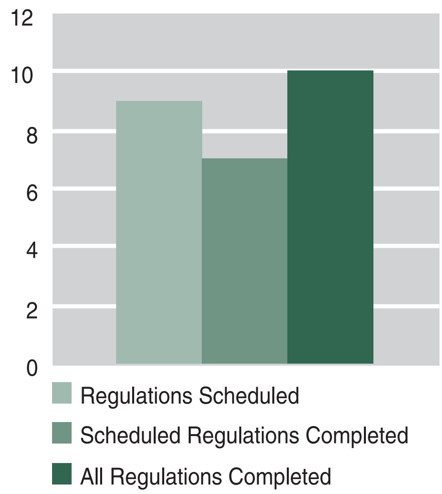
Our Strategic Plan contains seven objectives designed to assist the Agency in accomplishing its strategic goals. In this section, we evaluate our accomplishment of these objectives by examining 11 performance measures.

During FY 2001, we continued the implementation of initiatives to accomplish our strategic goals and fine-tuning how we measure our performance. We are committed to improving efficiency, minimizing the cost burden on FCS borrowers, and helping our customers meet the challenges and opportunities of the future.

We accomplished all but one of our performance measures. We completed seven of the nine Board actions scheduled for FY 2001, which was a 78 percent completion rate, short of our goal of 90 percent.

Figure 8

Comparison of Scheduled and Completed Regulations, FY 2001



Performance Goals and Outcomes

Goal 1 — Ensure the Farm Credit System fulfills its public mission to provide constructive, competitive, and dependable credit and related services for agriculture and rural America.

The purpose of Goal 1 is to maximize opportunities for the FCS to provide competitive and dependable credit and services for agriculture and rural America. To measure our performance in these areas, we developed three Agency-level performance measures for effective regulation and public policy (see Table 9a, page 60). Along with these performance measures, FCA's Strategic Plan lists four objectives that provide additional guidance and direction for our activities in support of this goal.

Objective 1 — Ensure System institutions fulfill their public mission by reaching out to all potential customers.

FCA regulations implement the Farm Credit Act and are the means by which System institutions have authority to serve customers. Thus, it is critical that we plan and complete regulatory and policy projects that help maximize the System's ability to serve customers and remove impediments that prevent the System from serving all potential customers Congress has authorized it to serve.

A performance measure that helps us measure success for this objective is that we complete 90 percent of the regulatory projects that are scheduled in the Regulatory Performance Plan for the fiscal year. In FY 2001, we completed seven of the nine regulatory projects (78 percent) included in our annual Regulatory Performance Plan, which was 12 percent less than our performance measure goal. The projects we did not complete were final actions on the national charter initiative and the loan purchase and sales initiative. Instead of adopting the national charter regulation as final, the FCA Board extended the comment period to allow added time for public input and our consideration of public comments. At the beginning of FY 2002 (October 11, 2001), staff presented a draft final rule to the FCA Board. At the meeting, the FCA Board members indicated they would not proceed with the rule. The FCA Board deferred action on the loan purchase and sales initiative until FY 2002. It was adopted on December 13, 2001.

In addition to the planned regulatory projects, we completed three regulation projects not contained in the annual Regulatory Performance Plan (see Figure 8). The three new projects were (1) National Charter Initiative – Extension of Comment Period; (2) e-commerce proposed regulations; and (3) a public meeting to discuss Farm Credit System financing of OFIs.

The third project, in particular, should enhance the System's ability to reach out to all potential customers. We conducted a public meeting on FCS financing of OFIs to gain information on how the FCS can better serve all potential customers through financing other non-System agricultural lenders.

Objective 2 — Ensure quality customer service at lowest cost through healthy competition.

A performance goal that helps us measure success for this objective is to use special customer focus or features on 40 percent or more of the regulation actions taken. For example, in response to requests from the public, we extended the comment period on our national charter initiative to obtain further comments. We used such features on 100 percent of the Board actions completed in FY 2001, which greatly exceeds our 40 percent performance goal.

Another way we measure performance on this and the following objective is by obtaining customer feedback on our success in meeting the objectives outlined in our regulations. Customer feedback was obtained by an FCA Inspector General survey. This process helped to preserve the independence and confidentiality of the survey and contained the following questions:

1. Did our rulemaking and policy activities recognize market forces and encourage innovation for System institutions?
2. Did we adequately involve the public in seeking its perspective regarding our rulemaking activities?
3. Did our rulemaking and policy activities implement the Farm Credit Act without imposing unnecessary burden?

Respondents answer these questions on a rating scale of 1 to 5, with 1 being the highest rating. Our goal for the survey is to have an average rating of less than 2.5. In the beginning of the fiscal year, the FCA Inspector General conducted a survey of 247 constituents (FCS institutions and commenters to regulatory actions taken by FCA during FY 2000). The ratings for questions 1, 2, and 3, were 2.30, 2.27, and 2.35, respectively, for an overall average of 2.31. We will evaluate the survey responses, improve the survey as needed, and survey constituents on FY 2001 regulations early in FY 2002.

Objective 3 — Enable the System to serve evolving customer needs and compete in new agricultural and financial markets.

To enable the System to serve evolving customer needs, we adopted the proposed e-commerce regulations. Through these regulations, we ensure that System customers can use technological advances in lending and gain efficiencies through time and various resource savings. We expect System customers who live in rural areas to benefit greatly by using the electronic medium to transact business. In what some may view as a very far-reaching step in serving evolving customer needs, we reproposed amendments to our termination regulations. The regulations describe how any lending institution of the System can apply to terminate its charter and become a financial institution under another Federal or state chartering authority. In addition, we adopted the stock issuance regulations that allow System service corporations to sell stock to non-System entities. These regulations could help in forming alliances and in bringing services to System borrowers.

We also continued our efforts to enable the System to serve new agricultural and financial markets. We hosted visitors from Brazil, South Africa, Bosnia, and Indonesia and briefed them on the System and ways the U.S. model of financing agriculture and rural America could be used in their countries.

Objective 4 — Enable optimum utilization of Farmer Mac by the FCS and other agricultural and rural housing mortgage lenders for the benefit of agricultural producers and rural America.

In FY 2001, we adopted risk-based capital regulations, which outline Farmer Mac's risk-based capital requirements. The rule requires additional capital if loan portfolio and/or interest rate risks increase. Farmer Mac has one year to implement the rule and will have to comply with the new risk-based capital requirements beginning May 23, 2002. Also, FCA, through OSMO, maintains ongoing oversight of Farmer Mac's operations and financial performance and condition. In addition, OSMO directs the annual examination of Farmer Mac regarding its safety and soundness and compliance with laws and regulations. These combined regulatory measures help to ensure that Farmer Mac remains in a safe and sound condition and that it is able to provide the secondary market for agricultural and rural housing lenders for which it is chartered.

Goal 2 — Supervise risk to ensure the safety and soundness of the Farm Credit System for the benefit of stakeholders.

The purpose of Goal 2 is to ensure that the Agency accomplishes its primary mission of regulating and supervising the safety and soundness of the Farm Credit System. To measure our performance in this area, we developed eight Agency-level performance measures for effective examination and supervision (see Table 9b, page 61). Along with these performance measures, FCA's Strategic Plan lists three objectives that provide additional guidance and direction for our activities in support of this goal.

Objective 1 — Enhance the value and effectiveness of risk-based examination, oversight, and correction of problems to ensure the safety and soundness of FCS institutions.

We continued to enhance the value of our Reports of Examination, and our effectiveness in the correction of problems, by requiring corrective actions by institutions when we discover unsafe or unsound conditions and violations of laws or regulations. Of the 104

Reports of Examination issued in FY 2001, 29 contained 74 requirements. These requirements focused on correcting or addressing unsafe and unsound practices or violations of laws and regulations. The number of reports with required actions comprised 28 percent of the total issued in FY 2001, compared with 38 percent of the total reports issued in FY 2000. The decline in required actions correlates with the improving risk-bearing capacity of the System over the past few years. Nevertheless, our Reports of Examination continued to contain recommendations to further strengthen the operations of System institutions in accordance with sound business practices.

We continued to use our Financial Institution Rating System to identify changes in institution risk characteristics. This process includes evaluating the risk in each bank and direct-lender institution every 90 days to make sure assigned ratings reflect current risk and conditions in the System. For the first time since 1999, a quarterly risk analysis reflected more rating downgrades than upgrades. As of March 31, 2001, we downgraded six composite ratings (all from 1 to 2) and upgraded only one (from 2 to 1). FIRS component ratings changes consisted of 11 upgrades versus 14 downgrades. While this was not indicative of an adverse trend because FIRS ratings continued to improve through September 30, 2001, it exemplifies how we use FIRS as an early warning indicator.

Semiannually, we review and analyze the System's new money, refinancing, and rollover trends. This review and analysis identifies the sources of growth in FCS institutions and the potential for transfer of risk from other lenders to FCS institutions, especially during stressful times in agriculture. The most recent report, evaluating trends from 1997 to 2001 among direct lenders in the FCS, did not reflect any material concerns with new money loaned, refinanced debt, or rollovers in FY 2001.

We continued to enhance our effective correction of problems in System institutions by using a three-tiered supervision program (normal, special, and enforcement) to clearly distinguish the risks and special oversight needs of institutions. During FY 2001, only one institution was under special supervision, and no institutions were under an enforcement action.

Objective 2 — Develop regulatory guidance and examination procedures that address new ventures of System institutions, such as e-commerce activities.

During FY 2001, we developed regulatory guidance on important subjects via examination focus areas and pro forma examination procedures, as well as expectations for new ventures such as e-commerce activities.

FCA examiners have been completing a standard examination program for loan portfolio management, which includes a subsection on the relatively untested venture of scorecard lending. The scorecard lending subsection includes procedures to assess (1) the process for establishing the statistical validity of the credit scoring model; (2) actions to address the impact of changing conditions on odds tables for payment; (3)

the risk associated with override decisions; (4) the adequacy of risk controls over the credit scoring process; and (5) overall management and servicing of the scored loan portfolio. Completion of the standard examination program facilitates conclusions regarding whether an institution's scorecard portfolio is appropriately managed and is within the institution's risk-bearing ability.

We have established e-commerce as a specific examination focus area for FY 2002. Three standard examination programs have been developed for examiners to facilitate conclusions regarding whether management has taken appropriate actions to ensure the safety of its information and protect the institution and its borrowers. To further develop our expertise in this budding channel for delivering financial services, in early FY 2002 we will conduct an e-commerce training course for post-commissioned examiners.

Quarterly through 2001, we conducted centralized reviews of institutions' Web sites. The reviews included all active Web sites, some of which were used by multiple institutions. Despite a decline in the total number of institutions, the number of Web sites has increased modestly, and a majority of institutions now have their own or share a Web site. A key part of these reviews was evaluating adherence to our November 8, 1999, Informational Memorandum titled "Web Site and Internet Guidelines." The reviews also assessed the use of transactional and other technological tools, advertising by other entities on System Web sites, and the use of Web sites to promote lending to young, beginning, small, and minority farmers. Overall, the reviews concluded that progress was being made but, in general, System institutions needed to devote more attention to the content and legal requirements for their Web sites.

We have begun to assess the number and extent of alliances and joint operations activities among FCS institutions, beyond chartered service corporations. Any concerns or issues that should be addressed as a result of these alliances are being identified as part of this assessment and will likely provide the basis for the development of regulatory guidance and examination procedures in the future.

Objective 3 — Design examination programs to evaluate the progress by FCS institutions in fulfilling the System's public mission.

Our examinations continued to focus on mission performance by the FCS, particularly in service to YBS farmers. In addition, a new mission measure was prepared for FY 2002 to focus additional attention on this important area.

During FY 2001, our examiners have been completing a standard examination program to determine the adequacy of FCS service to YBS farmers. Examiners evaluate an institution's practices in implementing and reporting on YBS lending programs and related services in accordance with applicable laws, regulations, policies, directives, and FCA Bookletter BL-040. Specifically, the YBS examination program includes evaluations of an institution's related policies and procedures, lending programs, risk management, business and marketing programs, marketing efforts, coordination with governmental or private sources of credit, and the accuracy of its database and reporting. In addition, examiners assess whether the institution has effectively analyzed the demographics of its loan portfolio in relation to the demographics of its territory and has taken appropriate program actions. Completion of this standard examination program was mandatory on all FY 2001 FCS examinations, and a similar examination program will be employed on all FY 2002 examinations.

We have identified business planning as an examination focus area for FY 2002. In support of this planned focus area, we developed a standard examination program for FY 2002 examinations. The program is designed to facilitate conclusions regarding whether management has implemented proper strategies to accomplish an institution's public mission in a safe and sound manner. Specifically, the business planning examination program includes an evaluation of whether an institution is achieving its public mission to serve agriculture and rural America, including efforts to serve YBS farmers and ranchers. The program requires examiners to scrutinize the quality of the institution's plans to serve its territory by determining whether the institution has:

- Described all segments of its existing market (including both existing and potential customers);
- Evaluated how well the institution is currently serving each segment of its existing market (including both existing and potential customers);
- Assessed underserved segments in the institution's existing market;
- Assessed the institution's capacity to serve all segments of its existing markets (including both existing and potential customers) and any constraints on this capacity; and
- Described the strategies the institution will pursue to ensure that it provides adequate service within its territory.

The program further prescribes the examination steps to be followed to evaluate whether the institution has clearly defined its public mission and established a means to measure and report on its results in achieving that mission. Completion of this examination program will be mandatory on all FY 2002 FCS examinations.

As Table 9b shows, the results for performance measures 4 through 9, which address the System's risk, capital adequacy, and earnings, show a fundamentally safe and sound Farm Credit System. Also, as reflected by performance measures 10 and 11, we continued to meet our statutory requirement for conducting examinations of System institutions, and the ratings received from the boards and management of most System institutions continued to reflect positively on the value of our examinations in helping them to correct identified weaknesses.

The tables that follow contain the measures for each outcome with the goals and objectives that reflect the Agency's desired performance for fiscal years 2001 and 2002. The symbols in the far right column offer a quick at-a-glance indicator of performance on each goal. For example:

▲	indicates that FCA's performance exceeded its FY 2001 outcome for that goal.
✓	indicates that FCA achieved the outcome.
▼	indicates that FCA did not achieve its outcome on that goal.
N/A	not applicable indicates that FCA's outcome against that goal could not be measured.

FCA Strategic Goal 1 — Ensure the Farm Credit System fulfills its public mission to provide constructive, competitive, and dependable credit and related services for agriculture and rural America.

Table 9a
Performance Measures and Outcomes

Description	Measure	FY 2001 Goal	FY 2001 Outcome	FY 2001 Outcome vs. Goal
1. The total number of regulation projects completed compared to the number of regulation projects in the Board-approved annual Regulatory Performance Plan.	Seven of nine scheduled Board actions (78%) were completed during FY 2001. However, during FY 2001 the Board took 10 actions, or 111% of the number of originally anticipated.	≥90%	78%	▼
2. Percentage of regulations completed that utilize "special" customer service focus or features.[1]	Special customer service focus or features were used on all completed regulations.	≥40%	100%	▲
3. Customer acceptance of recently adopted FCA regulations and policies through the average of ratings received on the following survey questions (1 to 5, with 1 being the highest rating):	In the beginning of the fiscal year, the FCA Inspector General (IG) conducted a survey of 247 constituents (FCS institutions and commenters to regulatory proposals we made during FY 2000). The IG received 138 responses. The average overall rating for the three questions in this measure was 2.31. The average rating for each question was:	≤2.50	2.31	▲
• Did our rulemaking and policy activities recognize market forces and encourage innovation for System institutions?	2.30			
• Did we adequately involve the public in seeking its perspective regarding our rulemaking activities?	2.27			
• Did our rulemaking and policy activities implement the Farm Credit Act without imposing unnecessary burden?	2.35			

1. "Special" customer service focus or features may include the following rulemaking techniques: Advance Notice of Proposed Rulemaking (ANPRM); Fast-Track or Streamlined Regulation Development Procedures; Direct Final Rulemaking; Reproposal or Resolicitation of Public Comments; Comment Period Extension; Question and Answer Format; Response to Petitions; and Information Meetings with Constituents or Congressional Committees.

FCA Strategic Goal 2 — Supervise risk to ensure the safety and soundness of the Farm Credit System for the benefit of stakeholders.

Table 9b
Performance Measures and Outcomes

Description	Measure	FY 2001 Goal	FY 2001 Outcome	FY 2001 Outcome vs. Goal
4. Risk—percentage of institutions having adverse assets within risk-bearing capacity.[1]	The number of direct-lender institutions with adverse assets to risk funds less than 100 percent divided by the total number of direct-lender institutions.	>90%	100%	▲
5. Risk—percentage of assets held by institutions having adverse assets within risk-bearing capacity.	The total assets of direct-lender institutions with adverse assets to risk funds less than 100 percent divided by the total assets of direct-lender institutions.	>85%	100%	▲
6. Risk—percentage of institutions with high adverse assets with corrective action plans in place.	The number of direct-lender institutions with adverse assets to risk funds greater than 100 percent with corrective action plans that mitigate the excessive risk.	100%	N/A	N/A
7. Capital Adequacy	The total assets of direct-lender institutions complying with all capital ratio requirements.	100%	100%	✓
8. System Earnings	The 3-year average return on equity (ROE) of System institutions.	7.55%[2]	10.18	▲
9. System Earnings	The 3-year average return on average assets (ROAA) of System institutions.	>1.25%	1.55	▲
10. Examination Frequency	The percentage of examinations of System institutions meeting statutory examination frequency requirement.	100%	100%	✓
11. Customer Acceptance	Customer acceptance of FCA's examination and supervisory programs through the average of the ratings received on the following survey questions (1 to 5, with 1 being the highest rating):			
	• The board and management believe the findings of the examination will assist (or have assisted) the institution in correcting identified weaknesses.	<2.25	1.66	▲
	• The board and management believe the actions required by the enforcement document will assist (or have assisted) the institution in correcting identified weakness.	<2.5	N/A	N/A

1. Adverse Assets/Risk Funds: The sum of all assets classified Substandard, Doubtful, or Loss plus other property owned, divided by risk funds. Risk funds are defined as permanent capital (defined above) plus the allowance for losses on loans and other property owned. Measures risk exposure of assets with well-defined credit factor weaknesses relative to risk-bearing ability; the lower the ratio the better.
2. 10-year Treasury bond rate of 5.55% plus 2% = 7.55%

Farm Credit Administration Management Systems, Controls, and Legal Compliance

This section provides information on FCA's compliance with the

- Inspector General Act;
- Federal Managers' Financial Integrity Act (FMFIA);
- Federal Financial Management Improvement Act (FFMIA);
- Prompt Payment Act;
- Civil Monetary Penalty Act; and
- Debt Collection Act.

Inspector General Act

The Inspector General Act of 1978, as amended, requires semiannual reporting on Inspector General audits and related activities as well as Agency follow-up. The Inspector General's two semiannual reports covering FY 2001 are summarized in this *Performance and Accountability Report*. This summary provides information about recommendations made in audits and inspections by the Office of Inspector General, management's progress in taking corrective action, and internal management controls.

OIG continues to report actions required to correct audit or inspection findings as "agreed-upon actions" whenever OIG and management have agreed on a mutually acceptable way to resolve a problem identified during reviews. OIG's objective is to recognize management's preferred method of correcting problems whenever the approach is reasonable. The term "recommendation" often includes these agreed-upon actions.

Summary of Audit and Inspection Recommendations

October 1, 2000, to September 30, 2001

Recommendations uncorrected at October 1, 2000	18
Recommendations made during FY 2001	19
Recommendations corrected during FY 2001	21
Open recommendations at September 30, 2001	16
Recommendations open more than one year	0

Federal Managers' Financial Integrity Act

FMFIA requires agencies to implement and maintain financial management systems that substantially comply with Federal financial management systems requirements, Federal Accounting Standards, and the U.S. Government Standard General Ledger. It also requires OIG to report on the Agency's compliance.

FCA management installed new financial management software (FFS™) as of June 1, 2001, to correct systemic weaknesses in the predecessor system. FFS™ was the Agency's system of record for FY 2001. FINASST™ — the predecessor system — did not substantially comply with Federal financial management systems requirements to produce financial statements for the fiscal year ended September 30, 2000. However, for FY 2001 FCA is in substantial compliance with the requirements of FMFIA.

Summary of Audit Activities for FY 2001

At the beginning of FY 2001, there were 18 unimplemented recommendations. Five were from the audit report of FCA's Supply and Procurement Functions issued March 29, 2000; two were from the inspection report of FCA's Performance Measures issued March 24, 2000; one was from the inspection report on Telecommunications Costs and Services issued March 28, 2000; one was from the inspection report on Imprest Fund issued May 4, 2000; eight were from Cash Management and Investment Practices issued September 28, 2000; and one was from the inspection report of the Denver Field Office issued September 29, 2000.

OIG issued four audit reports and three inspection reports during FY 2001. These reports contained a total of 19 recommendations.

During this reporting period, management worked with OIG to close 21 recommendations — 18 from reports issued in FY 2000 and three from reports issued in FY 2001.

At the end of the FY 2001 reporting period, there were 16 agreed-upon actions remaining open. Twelve agreed-upon actions are from the audit of Performance Budgeting issued March 23, 2001. Four agreed-upon actions are from the inspection report on Affirmative Employment Program Action Plan issued May 23, 2001. Management decisions have been made on all these recommendations, and corrective actions are in progress.

Federal Financial Management Improvement Act

FFMIA requires agencies to report on their substantial compliance with Federal financial management system requirements, Federal Accounting Standards, and the U.S. Government Standard General Ledger. The Agency is in substantial compliance with Federal Accounting Standards, the U.S. Government Standard General Ledger, and the financial management system requirements for FY 2001.

Prompt Payment Act

The Prompt Payment Act generally requires agencies to pay vendors 30 days after receipt of a valid invoice for goods and services ordered and delivered. During FY 2001, FCA paid most of its bills within the time requirement. In some instances invoices were received without complete or accurate information, which delayed payment while the invoices were returned to the vendor. FCA paid $6,000 in interest penalties for the payments that were not processed on time. Payments are made by electronic funds transfer unless payment by check is specifically authorized.

Civil Monetary Penalty Act

The Civil Monetary Penalty Act allows FCA to assess civil penalties against FCS institutions, including their officers, directors, employees, and agents, for violation of a valid order, law, or regulation. FCA did not assess any civil money penalties in FY 2001.

Debt Collection Act

The Debt Collection Act prescribes standards for the administrative collection, compromise, suspension, and termination of agency collection actions, and referral to the proper agency for litigation. Debt collection has no material effect on FCA, because we operate virtually without delinquent debt.

Farm Credit Administration Financial Statements

Farm Credit Administration

Office of Inspector General
1501 Farm Credit Drive
McLean, Virginia 22102-5090
(703) 883-4000

December 20, 2001

The Honorable Michael M. Reyna
Chairman of the Board
Farm Credit Administration
1501 Farm Credit Drive
McLean, Virginia 22102-5090

Dear Mr. Chairman:

This letter transmits Harper, Rains, Stokes & Knight's, P.A. (HRSK) reports on the audit of the Farm Credit Administration's (FCA) financial statements for the fiscal year ended September 30, 2001. This letter also incorporates a summary of what I believe are the most serious management and performance challenges facing the agency as described in the Office of Inspector General (OIG) Semiannual Report to Congress dated September 30, 2001.

HRSK issued an unqualified opinion. HRSK's opined FCA's principal financial statements present fairly, in all material respects, the financial position of FCA as of September 30, 2001 and 2000, in conformity with generally accepted accounting principles. HRSK issued two other reports and will issue a management letter. The report on the internal control noted no matters involving the internal control and its operation that HRSK considered to be material weaknesses. The HRSK report on compliance with laws and regulations does not note any instances of noncompliance. HRSK noted other matters involving internal control and its operations that will be reported to management in a separate letter.

The OIG tasked HRSK, an independent accounting firm, to perform the audit. The task order required HRSK to perform the audit in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States, and the Office of Management and Budget Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements.* To ensure the quality of the work performed, the OIG:

- reviewed HRSK's approach and planning of the audit;
- evaluated the qualifications and independence of the auditors;
- monitored progress of the audit;
- examined working papers; and
- reviewed the audit report.

In our opinion, HRSK's work provides a reasonable basis on which to render its December 7 opinion and we concur with the report.

As part of the Agency Accountability and Performance Report, the Inspector General is required to provide an opinion on the most serious management and performance challenges facing the Agency. In the most recent Semiannual Report to Congress, I outlined major challenges confronting the Farm Credit Administration as it works to fulfill its mission. These challenges fall into two general categories. First are the challenges related to the FCA's core mission of ensuring a dependable supply of credit to agriculture through the institutions it has chartered. These challenges are often shaped and influenced by events that are outside the control of the Agency. Second, but no less important, are those challenges related to the Agency's operations.

Organizational Leadership — The Farm Credit Act provides for a full time three-member Board of Directors. The board members are appointed by the President and confirmed by the Senate. The rapidly changing complex financial and banking environment makes the Board's task both challenging and important. The Board must be able to engage in healthy professional policy debate and set a sound course for the Agency. A full strength Board is an important element in setting clear priorities and deliberating fully on the issues. In the 15 years since the inception of the FCA Board, it has been at full strength for less than half of that time. It has been missing one Board member since January 2000 except for a brief 20-day period.

Farm Credit System Risk — The Farm Credit System is a single industry lender and therefore is vulnerable to economic swings in the industry. The Farm Credit Administration is challenged to balance the often-competing demands of ensuring the System fulfills it public purpose, proactively examining risk in the regulated institutions both individually and systemically, and controlling the cost of the regulator.

Financial Management — FCA's financial management system has undergone almost continuous change over the past five years. During this reporting period, the Agency implemented a new system by contracting for processing services with Department of Interior's National Business Center. While the implementation appears to have occurred smoothly, management's challenge will be to use the system to develop the financial information that is critical to well informed management decisions.

Security — The events of September 11, 2001 serve as a stark reminder that security must remain a major challenge for the Agency. In the recent report on information security, this Office found a strong foundation for security practices. However, the speed of change in the security environment will be a challenge for all government organizations. This is especially true for smaller organizations like FCA where an increased emphasis on physical and information security will compete with program areas for tight budget funding.

Human Capital — FCA needs to develop a comprehensive, integrated approach to human capital issues. The FCA has not adopted a human capital strategy. In light of the changes in the competitive environment, advances in technology, and the tenure of its workforce, FCA needs to closely evaluate business processes, their associated costs, and alternatives.

Leveraging Technology — The Agency has recognized that in order to meet the constraints of its budget, it must be able to maximize its return on investment in technology. FCA will need effective mechanisms to ensure that current and future staff have the technical skills to use technology to operate in an efficient manner.

Respectfully,

Stephen G. Smith

Stephen G. Smith
Inspector General

Farm Credit Administration Report of Management

The management of the Farm Credit Administration is responsible for the accompanying Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, Statement of Budgetary Resources, and Statement of Financing for the years ended, September 30, 2001 and 2000. Management is responsible for the integrity, objectivity, consistency, and fair presentation of the financial statements and financial information contained in this *Performance and Accountability Report* (Report).

Management maintains and depends upon an internal accounting control system designed to provide reasonable assurance that transactions are properly authorized and recorded, that the financial records are reliable as the basis for the preparation of all financial statements, and that the assets of the Agency are safeguarded. The design and implementation of all systems of internal control are based on judgments required to evaluate the costs of controls in relation to the expected benefits and to determine the appropriate balance between these costs and benefits. The Agency's Inspector General performs various audits of the accounting systems and internal controls. Audit reports including appropriate recommendations are provided to the FCA Board.

Independent public accountants whose report appears elsewhere in this Report have examined the financial statements. In addition, in planning and performing the audit of the Agency's financial statements, the independent public accountants obtained an understanding of the internal control structure and assessed the control risk in order to determine their audit procedures for the purpose of expressing their opinion on the financial statements. Their report on the internal control structure appears elsewhere in this Report.

In the opinion of management, the financial statements present fairly the financial position and results of operations of the FCA for the fiscal years ended September 30, 2001 and September 30, 2000, in conformity with accounting principles generally accepted in the United States of America.

W. B. Erwin
Chief Financial Officer

About the Farm Credit Administration and its Mission

The Farm Credit Administration is an independent agency in the executive branch of the United States Government. Initially created by an Executive Order of the President in 1933, FCA now derives its power and authority from the Farm Credit Act of 1971, as amended. Policy making of FCA is vested in a full-time, three-person board whose members are appointed by the President with the advice and consent of the Senate.

FCA is responsible for the regulation and examination of the banks, associations, and related entities that collectively comprise the Farm Credit System that was described earlier in this report. Specifically, FCA is empowered to ensure safe and sound operation of all System institutions. The Act requires System institutions to be examined periodically by FCA. FCA is also responsible for examination and regulation of the Federal Agricultural Mortgage Corporation (FAMC) through the Office of Secondary Market Oversight.

FCA operates under authorities conferred by the Act. The operations of FCA are financed by means of a revolving fund. This fund is reimbursed primarily from assessments received from the System institutions examined by FCA. Institutions are assessed or otherwise charged directly and billed in accordance with a formula established by FCA regulations. Assessments and other income earned in excess of obligations are taken into consideration in determining the amount to assess System institutions in the subsequent fiscal year. All of FCA's administrative expenses are paid by the institutions it examines, regulates, or for which it provides reimbursable services. The Congress has usually imposed a limitation on the amount of obligations that may be incurred in the fund in a given fiscal year from assessments collected from FCS institutions and from Farmer Mac. The limitation imposed for fiscal year 2001 was $36,800,000. Budgetary resources cover all liabilities of the Agency.

About the Financial Statements

The comparative financial statements that follow have been prepared in accordance with the requirements of the OMB Bulletin Number 01-09, *Form and Content of Agency Financial Statements*. The fiscal year 2000 financial statements were restated to report a liability from prior periods for postemployment benefits to former employees and to comply with changes of *Form and Content of Agency Financial Statements* requirements (see Note 1). OMB Bulletin Number 01-09 incorporates the concepts and standards contained in the Statements of Federal Financial Accounting Concepts (SFFAC) and the Statements of Federal Financial Accounting Standards (SFFAS) recommended by the Federal Accounting Standards Advisory Board (FASAB) and approved by the Secretary of the Treasury, the Director of the OMB, and the Comptroller General. FASAB has been designated, by the American Institute of Certified Public Accountants Council, as the accounting standards-setting body for Federal Government entities. Therefore, the SFFAS constitute accounting principles generally accepted in the United States of America (GAAP) for the Federal Government. These concepts and standards have been set by FASAB to help Federal agencies comply with the requirements of the Chief Financial Officers Act of 1990 (CFO Act) as amended by the Government Management and Reform Act of 1994. The financial statements that follow consist of the Balance Sheet, the Statement of Net Cost, the Statement of Changes in Net Position, the Statement of Budgetary Resources, and the Statement of Financing.

The CFO Act required only certain Federal agencies to produce financial statements and have them audited. FCA was not one of the agencies mandated to comply with the CFO Act; however, Agency management elected to voluntarily do so. Voluntary compliance requires adherence to OMB Bulletin Number 01-09 and the related Federal accounting concepts and standards. Accordingly, the financial statements for FY 2001 and FY 2000 are prepared in accordance with GAAP. The statements are presented with prior year comparative information. The Statement of Custodial Activity contained in OMB Bulletin Number 01-09 is not included with these financial statements because it is not applicable to FCA. Additionally, the following limitations apply to the preparation of the financial statements:

- The financial statements have been prepared to report the financial position and results of operations of the Agency, pursuant to the requirements of 31 U.S.C. 3515(b). Although FCA is not one of the agencies listed under this statute, Agency management has elected to voluntarily comply with its requirements.

- While the statements have been prepared from the books and records of FCA in accordance with accounting principles generally accepted in the United States of America (GAAP) for Federal entities and the formats prescribed by OMB, the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records.

- The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity. One implication of this is that liabilities cannot be liquidated without legislation that provides resources to do so.

Performance and Financial Results

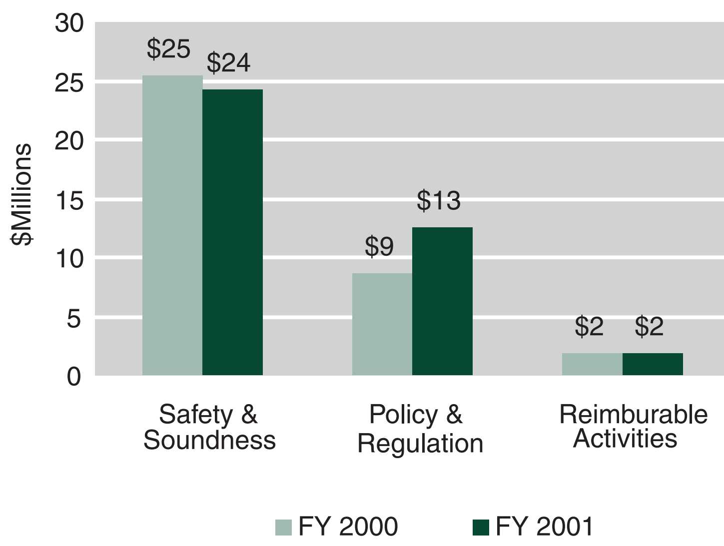
The following commentary reviews the financial condition and results of operations of the FCA for the fiscal years ended September 30, 2001, and September 30, 2000. This information should be read in conjunction with the financial statements, notes to the financial statements, and other sections of this *Performance and Accountability Report*. All amounts reported in the accompanying statements and related notes are presented in dollars.

The FCA continued to meet its performance goals for the FCS safety and soundness, policy and regulation, and reimbursable services performed for other government entities and Farmer Mac. In fiscal year 2001, the Agency's gross cost in the *Statement of Net Cost* increased $2,332,964 or 6 percent from fiscal year 2000. The rise in program cost resulted from an increase in employee salary and benefits and the conversion to a new financial management system. Earned revenues for the period grew $751,208 and partially offset the rise in expenses. As a result, the net cost of operations increased from $481,366 to $2,063,122 in fiscal year 2001.

FCA earned revenue continued to exceed its annual obligations. The added cash or budget resources allowed management to approve a $2,100,000 refund of prior year assessments collected from FCS institutions. For fiscal year 2001, FCA reported a negative budget outlay of $2,421,595 in the *Statement of Budgetary Resources*, indicating cash collections and adjustments exceeded the year's obligations and expenditures. The amount of the negative outlay (surplus cash or budget resources collected for the year) declined $1,403,218 from $3,824,813 for fiscal year 2000 because of the increased cost of opera-

Figure 9

Resources Used in FCA Programs in Fiscal Years 2000–2001



tions. The fiscal year 2001 negative budget outlay contributed to the Agency's $1,373,443 increase in net position reported on the *Balance Sheet* from the previous fiscal year.

The FCA adjusted its use of resources in 2001 to meet its performance goals with changes in U.S. agriculture and FCS. Figure 9 on page 70 shows FCA resource use in meeting program goals in fiscal years 2000 and 2001. Management increased its use of resources $3,785,567 in the policy and regulation program to meet changes in demand caused by System consolidation and the need for new regulations. Though System consolidation reduced the number of FCS institutions to examine, it placed additional demand on the policy and regulation program to review and approve charters for new institutions. FCA fell below its performance goal to complete policy regulation projects in fiscal year 2001. However, the Agency achieved its performance goals for safety and soundness, and reimbursable services.

Almost all Agency cash is derived from assessments, reimbursable activity, and interest earned on invested funds. Cash over and above that needed to fund the operations and liabilities of the Agency is generally refunded to System institutions on a pro-rata basis. The increases from fiscal year 2000 to 2001 in investments and accounts payable in the amounts of $2,717,933 and $2,062,356, respectively, are primarily due to approved but unpaid refunds of assessments in the amount of $2,100,000. Cash to be received from assessments and reimbursable activity in any given year is based on FCA Board-approved budgets that are expected to be adequate to fund the operations of the Agency for that year. The Board-approved budgets are usually subject to a limitation on administrative expenses imposed by the Congress.

The Board-approved assessments in the amounts of $36,800,000 and $35,800,000 for fiscal years 2001 and 2000, respectively, to fund its programs for insuring safety and soundness, providing policy and regulatory direction to the System, and performing reimbursable activities. The $1,000,000 increase in the FY 2001 budget over the FY 2000 budget is due to an increase in compensation and benefits that reflects salary increases for our workforce required by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) to keep FCA salaries comparable with those of other Federal financial institution regulators.

The Agency devoted approximately 66 percent of its FY 2001 budget to safety and soundness, primarily through examination of institutions, 29 percent to provide policy and regulatory direction to the System, and 5 percent to accomplish its reimbursable activities. These percentages changed based on the fiscal year 2001 cost to approximately 62 percent for ensuring FCS safety and soundness, 33 percent for providing FCS policy and regulatory direction, and 5 percent for accomplishing reimbursable activities.

HARPER, RAINS
STOKES & KNIGHT

INDEPENDENT AUDITOR'S REPORT ON THE FINANCIAL STATEMENTS

FARM CREDIT ADMINISTRATION
The Board and Office of Inspector General

We have audited the balance sheet of the Farm Credit Administration (FCA) as of September 30, 2001 and 2000, and the statements of net cost, changes in net position, budgetary resources, and financing for the years then ended. These financial statements are the responsibility of the FCA's management. 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; the standards applicable to financial statements contained in Government Auditing Standards, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin 01-02, "Audit Requirements for Federal Financial Statements". These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as, evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion the financial statements referred to above present fairly, in all material respects, the assets, liabilities, and net position of the Farm Credit Administration as of September 30, 2001 and 2000, and the net cost, changes in net position, budgetary resources, and reconciliation of net cost to budgetary resources for the years then ended in conformity with accounting principles generally accepted in the United States of America.

FCA restated its financial statements for the year ended September 30, 2000 to reflect the results of changing the responsibility segments used to report net cost, to correct an error in the FY 2000 year-end unobligated balance available, and to correct for errors associated with actuarial and due and payable Federal Employees Compensation Act Fund liabilities. See notes 1B, 8, and 12 for a detailed discussion of the changes.

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Our audit was conducted for the purpose of forming an opinion on the FY 2001 and 2000 principal financial statements of the FCA. The accompanying financial information discussed below is not a required part of the principal financial statements:

The Management Discussion and Analysis on pages 3; 6-7; 29-31; 33-34; 52-63; 68-71 and the Required Supplemental Information on pages 92-93 is supplementary information required by the Federal Accounting Standards Advisory Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the information. However, we did not audit the information and express no opinion on it. The information on pages 10-28; 35-51; and pages 94-102 is presented for purposes of additional analysis. Such information has not been subjected to the auditing procedures applied in the audits of the financial statements and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the management of the Farm Credit Administration, the Office of Management and Budget, and Congress. However, this report is a matter of public record and its distribution is not limited

Harper, Rains, Stokes & Knight P.A.

December 7, 2001

HARPER, RAINS
STOKES & KNIGHT

INDEPENDENT AUDITOR'S REPORT
ON INTERNAL CONTROL

FARM CREDIT ADMINISTRATION
The Board and Office of Inspector General

We have audited the Principal Statements (hereinafter referred to as "financial statements") of Farm Credit Administration (FCA) as of and for the year ended September 30, 2001 and 2000, and have issued our report thereon dated December 7, 2001. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and, Office of Management and Budget (OMB) Bulletin No. 01-02, "Audit Requirements for Federal Financial Statements."

In planning and performing our audit, we considered FCA's internal control over financial reporting by obtaining an understanding of the agency's internal control, determined whether internal controls had been placed in operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-02. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982, such as those controls relevant to ensuring efficient operations. The objective of our audit was not to provide assurance on internal control. Consequently, we do not provide an opinion on internal control.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the agency's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned

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functions. Because of inherent limitations in internal controls, misstatements, losses, or noncompliance may nevertheless occur and not be detected. However, we noted no matters involving the internal control and its operation that we considered to be material weaknesses as defined above.

With respect to internal control related to performance measures reported in the Performance report, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, as required by OMB Bulletin No. 01-02. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

We noted other matters involving the internal control and its operations that will be reported to the management of FCA in a separate letter.

This report is intended solely for the information and use of the management of FCA, OMB and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Harper, Rains, Stokes & Knight P.A.

December 7, 2001

HARPER, RAINS
STOKES & KNIGHT

INDEPENDENT AUDITOR'S REPORT
ON COMPLIANCE WITH LAWS AND REGULATIONS

FARM CREDIT ADMINISTRATION
The Board and Office of Inspector General

We have audited the Principal Statements (hereinafter referred to as "financial statements") of the Farm Credit Administration (FCA) as of and for the year ended September 30, 2001 and 2000, and have issued our report thereon dated December 7, 2001. We conducted our audit in accordance with: auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and, Office of Management and Budget (OMB) Bulletin No. 01-02, "Audit Requirements for Federal Financial Statements."

The management of FCA is responsible for complying with laws and regulations applicable to the agency. As part of obtaining reasonable assurance about whether the agency's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin No. 01-02, including the requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996. We limited our tests of compliance to these provisions and we did not test compliance with all laws and regulations applicable to *FCA*.

The results of our tests of compliance with the laws and regulations described in the preceding paragraph exclusive of FFMIA disclosed no instances of noncompliance with laws and regulations that are required to be reported under Government Auditing Standards and OMB Bulletin No. 01-02.

Under FFMIA, we are required to report whether the agency's financial management systems substantially comply with the Federal financial management systems requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA section 803(a) requirements.

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The results of our tests disclosed no instances in which the agency's financial management systems did not substantially comply with the Federal financial management systems requirements, United States Government Standard General Ledger at the transaction level and applicable Federal accounting standards.

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion.

This report is intended solely for the information and use of the management of FCA, OMB and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Harper, Rains, Stokes & Knight P.A.

December 7, 2001

FINANCIAL STATEMENTS AND RELATED NOTES

FARM CREDIT ADMINISTRATION
BALANCE SHEETS
As of September 30, 2001 and 2000

	2001	2000 Restated
Assets:		
Intragovernmental:		
Fund Balance With Treasury (Note 2)	$ 752,291	$ 1,065,282
Investments (Note 3)	19,986,030	17,268,097
Accounts Receivable (Note 4)	370,319	109,112
Prepaid Expenses	2,496	4,015
Total Intragovernmental	21,111,136	18,446,506
Accounts Receivable	157,597	160,283
Cash and Other Monetary Assets	1,500	1,500
General Property And Equipment, Net (Note 5)	904,990	278,243
Prepaid Expenses	17,594	5,197
Total Assets	$22,192,817	$18,891,729
Liabilities:		
Intragovernmental:		
Accounts Payable	$ 169,493	$ 70,354
Accrued Postemployment Compensation (Note 8)	361,084	178,001
Total Intragovernmental Liabilities	530,577	248,355
Accounts Payable	2,366,327	403,110
Accrued Payroll And Benefits	4,339,564	4,082,264
Actuarial Liability (Note 8)	1,110,156	1,193,504
Deferred Revenue	1,489,161	1,980,907
Total Liabilities	9,835,785	7,908,140
Net Position:		
Cumulative Results Of Operations	12,357,032	10,983,589
Total Net Position	12,357,032	10,983,589
Total Liabilities And Net Position	$22,192,817	$18,891,729

The accompanying notes are an integral part of these financial statements.

FARM CREDIT ADMINISTRATION
STATEMENTS OF NET COST
For The Years Ended September 30, 2001 And 2000

	2001	2000 Restated
Costs:		
Safety And Soundness:		
Intragovernmental Gross Costs	$ 1,710,626	$ 1,380,863
Less: Intragovernmental Earned Revenues	(702,960)	(743,041)
Intragovernmental Net Costs	1,007,666	637,822
Gross Costs With The Public	22,364,797	24,094,097
Less: Earned Revenues From The Public	(22,138,080)	(24,430,743)
Net Costs With The Public	226,717	(336,646)
Total Net Costs – Safety And Soundness:	$ 1,234,383	$ 301,176
Policy And Regulation:		
Intragovernmental Gross Costs	$ 791,536	$ 557,866
Less: Intragovernmental Earned Revenues	(365,507)	(254,707)
Intragovernmental Net Costs	426,029	303,159
Gross Costs With The Public	11,726,583	8,174,686
Less: Earned Revenues From The Public	(11,510,789)	(8,374,606)
Net Costs With The Public	215,794	(199,920)
Total Net Costs – Policy And Regulation:	$ 641,823	$ 103,239
Reimbursable Activities:		
Intragovernmental Gross Costs	$ 124,760	$ 116,562
Less: Intragovernmental Earned Revenues	(877,244)	(1,110,882)
Intragovernmental Net Costs	(752,484)	(994,320)
Gross Costs With The Public	1,776,855	1,838,119
Less: Earned Revenues From The Public	(828,227)	(766,848)
Net Costs With The Public	948,628	1,071,271
Total Net Costs – Reimbursable Activities:	$ 196,144	$ 76,951
Costs Not Assigned To Programs	0	0
Less: Earned Revenues Not Attributed To Programs	(9,228)	0
Net Cost Of Operations (Note 11)	$ 2,063,122	$ 481,366

The accompanying notes are an integral part of these financial statements.

FARM CREDIT ADMINISTRATION
STATEMENTS OF CHANGES IN NET POSITION
For The Years Ended September 30, 2001 And 2000

	2001 Cumulative Results Of Operations	2000 Cumulative Results Of Operations Restated
Net Position - Beginning Of Period	$10,983,589	$ 7,969,512
Other Financing Sources:		
Imputed Financing:		
Federal Employee Benefits (Note 7)	1,559,592	1,449,246
Rent (Note 10)	1,876,973	2,046,197
Total Financing Sources	$ 3,436,565	$ 3,495,443
Net Cost Of Operations	(2,063,122)	(481,366)
Net Position - End Of Period	$12,357,032	$10,983,589

The accompanying notes are an integral part of these financial statements.

FARM CREDIT ADMINISTRATION
STATEMENTS OF BUDGETARY RESOURCES
For The Years Ended September 30, 2001 And 2000

	2001	2000 Restated
Budgetary Resources:		
Unobligated Balances - Beginning Of Period (Note 12)	$ 10,122,345	$ 8,637,607
Spending Authority From Offsetting Collections		
Earned—Collected	37,847,252	36,173,926
Earned—Receivable From Federal Sources	205,096	37,787
Total Spending Authority From Offsetting Collections	38,052,348	36,211,713
Total Budgetary Resources (Note 12)	$ 48,174,693	$ 44,849,320
Status Of Budgetary Resources:		
Obligations Incurred—Exempt From Apportionment	$ 36,245,878	$ 34,726,975
Unobligated Balances-Available—Exempt From Apportionment	10,439,654	8,141,438
Unobligated Balances-Not Available	1,489,161	1,980,907
Total Status Of Budgetary Resources	$ 48,174,693	$ 44,849,320
Relationship Of Obligations to Outlays:		
Obligated Balance, Net—Beginning Of Period	$ 8,178,249	$ 5,838,588
Obligated Balance, Net—End Of Period:		
Accounts Receivable	$ (346,306)	$ (141,624)
Undelivered Orders	$ 1,906,469	$ 3,586,144
Accounts Payable	$ 7,233,625	$ 4,733,729
Outlays:		
Disbursements	$ 35,425,656	$ 32,349,113
Collections	(37,847,251)	(36,173,926)
Net Outlays	$ (2,421,595)	$ (3,824,813)

The accompanying notes are an integral part of these financial statements.

FARM CREDIT ADMINISTRATION
STATEMENTS OF FINANCING
For The Years Ended September 30, 2001 And 2000

	2001	2000 Restated
Resources Used To Finance Activities:		
Budgetary Resources Obligated:		
Obligations Incurred	$36,245,878	$ 34,726,975
Less: Spending Authority For Offsetting Collections And Recoveries	(38,052,348)	(36,211,713)
Net Obligations	(1,806,470)	(1,484,738)
Other Resources:		
Financing Imputed For Cost Subsidies (Notes 7 And 10)	3,436,565	3,495,443
Exchange Revenue Not In The Budget	(520,594)	536,134
Net Other Resources Used To Finance Activities	2,915,971	4,031,577
Total Resources Used To Finance Activities	1,109,501	2,546,839
Resources Used To Finance Items Not Part Of The Net Cost Of Operations:		
Change In Budgetary Resources Obligated For Goods, Services And Benefits Ordered But Not Yet Provided	1,668,796	(1,965,162)
Resources That Fund Expenses Recognized In Prior Period	(83,348)	(79,290)
Resources That Finance The Acquisition Of Assets	(1,001,516)	(191,517)
Total Resources Used To Finance Items Not Part Of The Net Cost Of Operations	583,932	(2,235,969)
Total Resources Used To Finance The Net Cost Of Operations	1,693,433	310,870
Components Of The Net Cost Of Operations That Will Not Require Or Generate Resources In The Current Period:		
Components Not Requiring Or Generating Resources:		
Depreciation And Amortization	305,853	169,262
Other Costs Not Requiring Resources	63,836	1,234
Total Components Of Net Cost Of Operations That Will Not Require Or Generate Resources In The Current Period	369,689	170,496
Net Cost Of Operations	$ 2,063,122	$ 481,366

The accompanying notes are an integral part of these financial statements.

Note 1. Significant Accounting Policies:

A. Reporting Entity – The Farm Credit Administration (FCA or Agency) is an independent agency in the executive branch of the U.S. Government. FCA is responsible for the regulation and examination of the banks, associations, and related entities that compose the Farm Credit System (FCS or System). Specifically, FCA is empowered to ensure safe and sound operations of all System institutions. Initially created by an Executive order of the President in 1933, FCA now derives its power and authority from the Farm Credit Act of 1971, as amended (Act). The Act requires System institutions to be examined periodically by FCA. Policy making for FCA is vested in a full-time, three-person board whose members are appointed by the President with the advice and consent of the Senate.

B. Basis of Accounting and Presentation – The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. FCA's transactions are recorded on the accrual basis of accounting. Under this method, revenues are recognized when earned, and expenses are recognized when goods or services are received, without regard to receipt or payment of cash.

The FCA has restated its financial statements by recording a prior period liability for actuarial and accounts payable for workers compensation benefits due FCA employees under the Federal Employees Compensation Act. In addition, FCA restructured its Responsibility Segments used to report net cost of operations resulting in a change in its reporting entity and corrected an error in FY 2000 year-end unobligated balance available.

The Chief Financial Officers Act of 1990 (CFO Act) required certain Federal agencies to develop financial statements that provide information useful to Congress, Government officials, and the public. FCA is not one of the Federal agencies mandated to adhere to the CFO Act; however, Agency management has voluntarily elected to have financial statements prepared and audited in accordance with this law. To comply with the CFO Act, the Agency's financial statements are presented in conformity with OMB Bulletin Number 01-09, *Form and Content of Agency Financial Statements.* The statements are presented with prior year comparative information. The Statement of Custodial Activity contained in OMB Bulletin Number 01-09 is not applicable to FCA and is not included with these financial statements.

C. Investments – FCA is authorized by the Act to invest in public debt securities with maturities suitable to FCA's needs. All investments are classified as held to maturity and carried at cost, adjusted for unamortized premiums or discounts. Premiums and discounts are amortized and interest is accrued using the straight-line method (which approximates the interest method) over the term of the respective issues.

D. Accounts Receivable – Accounts receivable are comprised of: (1) reimbursements of administrative expenses incurred by FCA according to agreements with other Federal entities, (2) assessments of institutions in accordance with the Act and FCA regulations, and (3) accounts owed FCA that are generated through the normal course of business with employees and vendors. The Office of Chief Financial Officer (OCFO) reviews the Agency's accounts receivable on an ongoing basis. The OCFO has determined that all accounts receivable are fully collectible as of September 30, 2001.

E. Property, Equipment, and Software – Property, equipment, and internal use software are recorded at cost, net of an allowance for accumulated depreciation. Repairs and maintenance costs are expensed as incurred. FCA operates under a policy that property, equipment, and internal use software with itemized costs of $5,000 or more and a useful life of two years or more is capitalized. During the fiscal year 2001, FCA capitalized a $716,252 acquisition of computer equipment purchased in bulk, which was determined material. The straight-line method of depreciation with half-year convention is used to allocate the cost of capitalized property, equipment, and internal use software over their estimated useful lives.

F. Rent – The Act provides for FCA to occupy buildings and use land owned and leased by the Farm Credit System Building Association (FCSBA), an entity owned by System banks. FCA is not charged for the use of the buildings or land, owned or leased, nor does it pay for maintenance and repair of buildings and land improvements.

G. Federal Employee Benefits – Each employing Federal agency is required to recognize its share of the Federal Government's cost and imputed financing for pension, post-retirement health benefits, and life insurance. Cost factors used in the calculation of these Federal employee benefits expenses were provided by the Office of Personnel Management (OPM) to each agency to meet this requirement.

H. Annual, Sick, and Other Leave – Annual leave is accrued as a liability when earned, with an offsetting reduction for leave taken. The accrued annual leave liability is calculated using current pay rates. Sick leave and other types of non-vested leave are expensed as the leave is taken.

I. Assessments – A substantial portion of FCA's revenue is based upon direct assessments billed to System institutions that are regulated or examined by FCA. FCA also recognizes revenues based on examination services provided by the Office of Examination. Direct assessments are derived using a formula established in FCA regulations and are based, in part, upon the average risk adjusted assets and the overall financial health of the institution being assessed.

J. Deferred Revenue – Beginning in FY 1998, the Agency recognized revenue in accordance with SFFAS No. 7, *Accounting for Revenue and Other Financing Sources.* This was a change in accounting principle from previous years. Under SFFAS No. 7, the entire amount of assessment revenue is recognized ratably over the fiscal year. Assessments paid in advance for the subsequent fiscal year are reported as deferred revenue in the Balance Sheet.

Note 2. Fund Balance with Treasury:

	2001	2000
Fund Balance With Treasury:		
Revolving Fund	$ 752,291	$ 1,065,282
Total Fund Balance With Treasury	$ 752,291	$ 1,065,282
Status Of Fund Balance With Treasury:		
Unobligated Balance:		
Available	$ 10,439,654	$ 8,141,438
Unavailable	1,489,161	1,980,907
Obligated Balance	8,793,788	8,178,249
Subtotal – Status Of Fund Balance	20,722,603	18,300,594
Funds Invested With Treasury, Net Of Unamortized Discount	(19,968,812)	(17,233,812)
Cash Held Outside Treasury	(1,500)	(1,500)
Total Fund Balance With Treasury	$ 752,291	$ 1,065,282

Note 3. Investments:

Intragovernmental Securities:
Amounts for 2001 Balance Sheet Reporting

	(1) Amortized Cost	(2) Unamortized (Premium) Discount	(3) Investments Net	(4) Required Market Value Disclosure
Non-Marketable:				
Market-Based	$ 19,970,643	$ 357	$ 19,971,000	$ 19,982,875
Accrued Interest	15,387	0	0	15,387
Total	$ 19,986,030	$ 357	$ 19,971,000	$ 19,998,262

Amounts for 2000 Balance Sheet Reporting

	(1) Amortized Cost	(2) Unamortized (Premium) Discount	(3) Investments Net	(4) Required Market Value Disclosure
Non-Marketable:				
Market-Based	$ 17,235,799	$ 201	$ 17,236,000	$ 17,236,501
Accrued Interest	32,298	0	0	32,298
Total	$ 17,268,097	$ 201	$ 17,236,000	$ 17,268,799

Premiums and discounts are amortized and interest is accrued using the straight-line method (which approximates the interest method) over the term of the respective issues. Interest earned on investments was $1,068,465 and $1,054,761 for fiscal years 2001 and 2000, respectively.

Note 4. Accounts Receivable:

	2001	2000
Intragovernmental:		
Reimbursements	$ 370,319	$ 109,112
Subtotal	370,319	109,112
With The Public:		
Assessments	105,299	112,429
Vendor Overpayments	50,318	19,858
Other	1,980	27,996
Subtotal	157,597	160,283
Total	$ 527,916	$ 269,395

Note 5. General Property, Equipment, and Software:

As of September 30, 2001

	Estimated Useful Life	Depreciation Method	Acquisition Value	Accumulated Depreciation	Book Value
ADP Equipment	3 years	Straight Line	$ 1,884,931	($ 1,025,921)	$ 859,010
Software	3 years	Straight Line	61,307	(15,327)	45,980
Total			$ 1,946,238	($ 1,041,248)	$ 904,990

As of September 30, 2000

	Estimated Useful Life	Depreciation Method	Acquisition Value	Accumulated Depreciation	Book Value
ADP Equipment	3 years	Straight Line	$ 1,128,568	($ 912,917)	$ 215,651
Software	3 years	Straight Line	313,926	(251,334)	62,592
Total			$ 1,442,494	($ 1,164,251)	$ 278,243

Note 6. Gross Cost and Earned Revenue by Budget Functional Classification:

Functional Classification	Gross Cost (*)	Earned Revenue	Net Cost
Agriculture			
2001	$38,495,157	$36,432,035	$2,063,122
2000	$36,162,193	$35,680,827	$ 481,366

(*) Intragovernmental costs were in the amounts of $2,626,922 and $2,055,291 for fiscal years 2001 and 2000, respectively.

Note 7. Federal Employee Benefits:

	2001	2000
Funded Pension Cost	$2,267,661	$2,089,780
Imputed Pension Cost	798,018	711,522
Other Imputed Retirement Benefits	761,574	737,724
Total	$3,827,253	$3,539,026

Retirement – FCA employees are covered under the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS) to which FCA makes contributions according to plan requirements. CSRS and FERS are multi-employer plans. FCA does not maintain or report information about the assets of the plan, nor does it report actuarial data for accumulated plan benefits. The reporting of such amounts is the responsibility of OPM, but the pension expense of the Agency's employees is reported in accordance with SFFAS No. 5 (see Note 1). A corresponding amount of imputed revenue is recorded to offset the imputed expense.

Other Retirement Benefits Expenses – SFFAS No. 5 (see Note 1) requires employing Federal agencies to recognize an expense for the cost of providing health benefits and life insurance to its employees after they retire. Factors used to calculate these costs were provided by OPM to meet this requirement. A corresponding amount of imputed revenue is recorded to offset the expense.

Note 8. Postemployment Compensation:

The Federal Employee Compensation Act (FECA) provides income and medical cost protection to cover Federal civilian employees injured on the job, employees who have contracted a work-related occupational disease, and beneficiaries of employees whose death is attributable to a job-related injury or occupational disease. Claims for benefits under the FECA for eligible FCA employees are administered by the Department of Labor (DOL) and ultimately paid by the FCA.

The DOL estimates future workers compensation (FWC) liability for specified entities preparing statements under the Chief Financial Officers Act and Government Management Reform Act. The actuarial liability estimates for FECA benefits include the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. However, the FCA is not one of the specified entities for which DOL provides individual agency estimates of its FWC liability.

The FWC liability represents the actuarial liabilities of future FECA benefit payments under existing plans for former FCA employees. The FCA estimated the present value of projected benefit payments of the plans existing at the end of the fiscal year based on a discount rate derived from U.S. Treasury rates. The actuarial liability was $1,110,156 and $1,193,504 as of September 30, 2001 and 2000, respectively.

FCA elected in fiscal year 1999 to annually reimburse the DOL for the actual benefit payments paid to its employees upon receiving notification of claims incurred. The FCA has an outstanding liability in the amount of $361,084 with the DOL as of September 30, 2001. A portion of this amount, $178,001, is applicable to fiscal year 2000 and is included in the restated statements. The DOL incorrectly notified FCA that a liability did not exist in fiscal year 2000. DOL discovered the error and informed FCA of the error after prior year statements were published.

Note 9. Other Employee Benefits:

Annual and Sick Leave – FCA's employees earn annual leave (vacation and personal time) based on years of service and sick leave of four hours per pay period. Annual leave is accrued as a liability when earned, generally up to a maximum of 240 hours per employee. The amount of the liability is based on current pay rates and is reduced as leave is taken. Any outstanding balance is payable to employees upon separation. Sick leave is not vested and is expensed as used.

Health Benefits and Life Insurance – Health benefits and group life insurance are provided through the Federal Employees Health Benefits (FEHB) plan and the Federal Employees Group Life Insurance (FEGLI) plan. Previously, group life insurance was also available through the FCA Group Life Insurance Program. Under these plans, premium costs are shared between the Agency and the employee. The FCA Group Life Insurance Program is now closed to new enrollees. FCA funds the premiums for FCA Group Life Insurance held by retirees.

Leave Bank Program – FCA administers a voluntary leave bank program that allows employees to donate annual leave to a leave bank for use by members in connection with personal or family medical emergency situations. Leave must be donated annually for an individual to become a member. Leave is accrued as a liability when donated. The amount of the liability is based on an average hourly pay rate.

Disability Insurance – The Agency provides disability insurance, at no cost, to all employees who work at least 30 hours or more per pay period.

Flexible Spending Plan – FCA has established flexible spending accounts (cafeteria plan) for reimbursement to its employees of medical expenses and dependent care expenses from pre-tax payments withheld from their salary. The Agency, in fiscal year 2001, contributed $750 to each employee's account totaling $218,923. Fiscal year 2001 was the first year the Agency contributed to employees' accounts. Amounts contributed to the accounts that are not paid out as reimbursements are forfeited to the Agency at the end of the plan year. The Agency is liable for amounts paid out that are in excess of the amounts paid into the accounts in any plan year. This typically occurs when an employee leaves the Agency during the year and reimbursements paid to the employee exceed the amount of withholding the employee has contributed to the plan.

Employee Assistance and Wellness Program – FCA funds an employee assistance and wellness program to increase employee efficiency and productivity. The employee assistance program is designed to assist employees who voluntarily seek counseling or who have been encouraged by their supervisors to seek counseling. The employee wellness program provides annual reimbursement up to $150 for periodic, routine physical examination or health screening costs that are not covered by health insurance. Employee Assistance and Wellness Program expenses were $12,338 and $10,164 for fiscal years 2001 and 2000, respectively.

Note 10. Rent:

	2001	2000
Leased Field Offices	$ 752,770	$ 741,096
FCA Headquarters	1,124,203	1,305,101
Total	$ 1,876,973	$ 2,046,197

In accordance with the Act, FCA occupies buildings owned and leased by the FCSBA. The FCA administrative headquarters building and land are located in McLean, Virginia. In addition, the FCSBA leases office space for field offices on behalf of FCA at various locations throughout the United States. Rent is provided at no cost to FCA. The above imputed rent expense is an estimate based on FCSBA actual results of operations for the 12 months ended December 31, 2000.

In accordance with SFFAS No. 4, the rent expense and the associated imputed revenue are recorded as a non-monetary transaction (see Note 1). The full cost of the rent expense is calculated by subtracting, from the gross operating expenses of the FCSBA, the amount of rental income received from commercial tenants renting office space. The lease expenses for the field offices are included in FCSBA's gross operating expenses.

Note 11. Sub-Organization Program Costs/Program Costs by Segment:

Farm Credit Administration
Supporting Schedule by Sub-organization
For The Year Ended September 30, 2001

			Office		
	Examination $	Policy & Analysis $	Secondary Market Oversight $	Support Organization $	Total $
Safety & Soundness:					
Intragovernmental	0	0	0	1,710,626	1,710,626
With The Public	13,726,022	639,953	4,275	7,994,547	22,364,797
Total	13,726,022	639,953	4,275	9,705,173	24,075,423
Less: Earned Revenue	(13,022,268)	(607,142)	(4,056)	(9,207,574)	(22,841,040)
Net Program Cost	703,754	32,811	219	497,599	1,234,383
Policy & Regulation:					
Intragovernmental	0	0	0	791,536	791,536
With The Public	116,824	5,047,649	355	6,561,755	11,726,583
Total	116,824	5,047,649	355	7,353,291	12,518,119
Less: Earned Revenue	(110,834)	(4,788,848)	(336)	(6,976,278)	(11,876,296)
Net Program Cost	5,990	258,801	19	377,013	641,823
Reimbursable Services:					
Intragovernmental	0	0	0	124,760	124,760
With The Public	597,811	148,569	318,682	711,793	1,776,855
Total	597,811	148,569	318,682	836,553	1,901,615
Less: Earned Revenue	(705,487)	(0)	(828,228)	(171,756)	(1,705,471)
Net Program Cost	(107,676)	148,569	(509,546)	664,797	196,144
Cost Not Assigned To Programs	0	0	0	0	0
Less: Earned Revenues Not Attributed To Programs	0	0	0	(9,228)	(9,228)
Net Cost Of Operations	602,068	440,181	(509,308)	1,530,181	2,063,122

Farm Credit Administration
Supporting Schedule by Sub-organization
For The Year Ended September 30, 2000

	Office				
	Examination $	Policy & Analysis $	Secondary Market Oversight $	Support Organization $	Total $
Safety & Soundness:					
Intragovernmental	0	0	0	1,380,863	1,380,863
With The Public	14,303,236	359,887	0	9,430,974	24,094,097
Total	14,303,236	359,887	0	10,811,837	25,474,960
Less: Earned Revenue	(14,134,138)	(355,633)	(0)	(10,684,013)	(25,173,784)
Net Program Cost	169,098	4,254	0	127,824	301,176
Policy & Regulation:					
Intragovernmental	0	0	0	557,866	557,866
With The Public	220,348	2,553,889	11,162	5,389,287	8,174,686
Total	220,348	2,553,889	11,162	5,947,153	8,732,552
Less: Earned Revenue	(217,743)	(2,523,696)	(11,030)	(5,876,844)	(8,629,313)
Net Program Cost	2,605	30,193	132	70,309	103,239
Reimbursable Services:					
Intragovernmental	0	0	0	116,562	116,562
With The Public	770,910	41,522	211,195	814,492	1,838,119
Total	770,910	41,522	211,195	931,054	1,954,681
Less: Earned Revenue	(740,561)	(39,887)	(202,881)	(894,401)	(1,877,730)
Net Program Cost	30,349	1,635	8,314	36,653	76,951
Cost Not Assigned To Programs	0	0	0	0	0
Less: Earned Revenues Not Attributed To Programs	(0)	(0)	(0)	(0)	(0)
Net Cost Of Operations	202,052	36,082	8,446	234,786	481,366

Note 12. Budgetary Resources:

The year-end unobligated balance available, for the financial statements issued for the period ending September 30, 2000, was overstated by $204,500 and FCA's financial statements issued for FY 2000 were restated.

The Total Budgetary Resources reported in these financial statements is $48,174,693. The budget authority for the FCA, in the Budget of the United States Government, is $46,000,000. The difference of $2,174,693 is due to the rounding, to the nearest million dollars per line item, within the OMB MAX budget system. The largest portion of this difference is the Unobligated Balance Available - start of year, which is $10,122,345 in the financial statements and $9,000,000 in the Budget of the United States Government.

Note 13. Related Parties:

FCSIC

FCSIC was established to provide an insurance function for the System. FCSIC is controlled by a board whose members are the same as the members of the FCA Board except the same individual cannot be the Chairman of both Boards.

FCA provides staff resources to FCSIC on a reimbursable basis. Services provided by FCA staff include examinations and administrative and legal support services. The amounts of the services provided were $180,673 and $237,000 for the fiscal years ended September 30, 2001 and 2000, respectively. Additionally in fiscal year 2001, FCA was refunded $368,372 from FCSIC as a reimbursement for FCSIC's portion of the implementation of a new financial management system.

The fiscal year 2001 and 2000 reimbursable from FCSIC include Intragovernmental accounts receivable of $39,322 and $40,901, respectively.

The memorandum of understanding between FCA and FCSIC to provide accounting services will end in fiscal year 2002.

FCSBA

The FCSBA was formed to provide a vehicle through which the banks of the System could acquire, construct, develop, own, hold, improve, maintain, lease, and dispose of physical facilities and related properties to house the offices of the FCA. In accordance with the Act, FCA occupies buildings owned and leased by FCSBA. Rent is provided at no cost to FCA (see Note 10). FCSBA also leases telecommunications equipment to FCA under a reimbursable operating lease that is renewable annually. Telecommunication expenses were $295,928 and $270,819 for fiscal years 2001 and 2000, respectively.

The FCSBA is assessed for each fiscal year in which FCA examines them. The assessment for fiscal year 2001 was $11,440. FCA performed no examination of FCSBA in fiscal year 2000. The FCA Board has exclusive oversight of the FCSBA and is authorized to act as the agent of the banks.

Required Supplemental Information:

Intragovernmental Assets:

As of September 30, 2001

Agency	Fund Balance with Treasury	Investments	Accounts Receivable	Prepayments
Department of Treasury	$ 752,291	$ 19,986,030	$ -	$ -
U.S. Department of Agriculture	-	-	172,298	-
Small Business Administration	-	-	157,862	-
Farm Credit System Insurance Corporation	-	-	39,322	-
Library of Congress	-	-	-	2,496
Internal Revenue Service	-	-	768	-
Legal Services Corporation	-	-	69	-
Total	$ 752,291	$ 19,986,030	$ 370,319	$ 2,496

As of September 30, 2000

Agency	Fund Balance with Treasury	Investments	Accounts Receivable	Prepayments
Department of Treasury	$ 1,065,282	$ 17,268,097	$ -	$ -
Small Business Administration	-	-	66,519	-
Farm Credit System Insurance Corporation	-	-	40,901	-
Library of Congress	-	-	-	4,015
Other	-	-	1,692	-
Total	$ 1,065,282	$ 17,268,097	$ 109,112	$ 4,015

Required Supplemental Information:

Intragovernmental Liabilities:

As of September 30, 2001

Agency	Accounts Payable	Other Liabilities
U.S. Department of Labor	-	$ 361,084
U.S. Department of Interior	$ 88,191	-
Office of Personnel Management	46,084	-
U.S. Department of Agriculture	21,655	-
Federal Deposit Insurance Corporation	9,720	-
Internal Revenue Service	2,843	-
U.S. Government Printing Office	1,000	-
Total	$ 169,493	$ 361,084

As of September 30, 2000

Agency	Accounts Payable	Other Liabilities
Office of Personnel Management[1]	$ 46,384	-
U.S. Department of Labor	-	178,001
U.S. Department of Agriculture	21,530	-
Federal Deposit Insurance Corporation	1,440	-
U.S. Government Printing Office	1,000	-
Total	$ 70,354	178,001

1. Liability with OPM in the amount of $46,084, was reclassified into Accounts Payable Payroll and Benefits.

Glossary

A

Agricultural Credit Association (ACA) — An ACA results from the merger of a Federal Land Bank Association or a Federal Land Credit Association and a Production Credit Association and has the combined authority of the two institutions. An ACA borrows funds from a Farm Credit Bank or Agricultural Credit Bank to provide short-, intermediate-, and long-term credit to farmers, ranchers, and producers and harvesters of aquatic products. It also makes loans to these borrowers for certain processing and marketing activities, to rural homeowners for housing, and to certain farm-related businesses.

Agricultural Credit Bank (ACB) — An ACB results from the merger of a Farm Credit Bank and a Bank for Cooperatives and has the combined authorities of those two institutions. An ACB is also authorized to finance U.S. agricultural exports and provide international banking services for farmer-owned cooperatives. CoBank is the only ACB in the Farm Credit System.

B

Bank for Cooperatives (BC) — A BC provides lending and other financial services to farmer-owned cooperatives, rural utilities (electric and telephone), and rural sewer and water systems. It also is authorized to finance U.S. agricultural exports and provide international banking services for farmer-owned cooperatives. The last remaining BC in the Farm Credit System, the St. Paul Bank for Cooperatives, merged with CoBank on July 1, 1999.

F

Farm Credit Act — The Farm Credit Act of 1971, as amended, is the statute under which the Farm Credit System operates. The Farm Credit Act recodified all previous acts governing the Farm Credit System.

Farm Credit Bank (FCB) — FCBs provide services and funds to local associations that, in turn, lend those funds to farmers, ranchers, producers and harvesters of aquatic products, rural residents for housing, and some agriculture-related businesses. On July 6, 1988, the Federal Land Bank and the Federal Intermediate Credit Bank in 11 of the 12 then existing Farm Credit districts merged to become FCBs. The mergers were required by the Agricultural Credit Act of 1987. As of September 30, 2001, there were six FCBs: AgAmerica, FCB; AgFirst Farm Credit Bank; AgriBank, FCB; Farm Credit Bank of Texas; Farm Credit Bank of Wichita; and Western Farm Credit Bank.

Farm Credit Leasing Services Corporation (Leasing Corporation) — The Leasing Corporation is a service entity owned primarily by two Farm Credit System banks — CoBank, ACB and AgFirst Farm Credit Bank — to provide equipment leasing and related services to eligible borrowers, including agricultural producers, cooperatives, and rural utilities. The other FCBs are nonvoting stockholders.

Farm Credit System Insurance Corporation (FCSIC) — The FCSIC was established by the Agricultural Credit Act of 1987 as an independent U.S. government-controlled corporation. Its purpose is to ensure the timely payment of principal

and interest on insured notes, bonds, and other obligations issued on behalf of Farm Credit System banks and to act as conservator or receiver of FCS institutions. The FCA Board serves ex officio as the Board of Directors for FCSIC; however, the chairman of the FCA Board is not permitted to serve as the chairman of the FCSIC Board of Directors.

FCA Financial Institution Rating System (FIRS) — The FIRS is similar to the Uniform Financial Institutions Rating System used by other Federal banking regulators. However, it has been modified by FCA to reflect the nondepository nature of Farm Credit System institutions. FIRS provides a general framework for assimilating and evaluating all significant financial, asset quality, and management factors to assign a composite rating to each System institution. The ratings, which range from 1 to 5, are described below.

Rating 1 — Institutions in this group are basically sound in every respect; any negative findings or comments are of a minor nature and are anticipated to be resolved in the normal course of business. Such institutions are well managed, resistant to external economic and financial disturbances, and more capable of withstanding the uncertainties of business conditions than institutions with lower ratings. These institutions exhibit the best performance and risk management practices relative to the institution's size, complexity, and risk profile. As a result, these institutions give no cause for regulatory concern.

Rating 2 — Institutions in this group are also fundamentally sound but may reflect modest weaknesses correctable in the normal course of business. The nature and severity of deficiencies are not considered material and, therefore, such institutions are stable and able to withstand business fluctuations. Overall risk management practices are satisfactory relative to the institution's size, complexity, and risk profile. While areas of weakness could develop into conditions of greater concern, regulatory response is limited to the extent that minor adjustments are resolved in the normal course of business and operations continue in a satisfactory manner.

Rating 3 — Institutions in this category exhibit a combination of financial, management, operational, or compliance weaknesses ranging from moderately severe to unsatisfactory. When weaknesses relate to asset quality and/or financial condition, such institutions may be vulnerable to the onset of adverse business conditions and could easily deteriorate if concerted action is not effective in correcting the areas of weakness. Institutions that are in significant noncompliance with laws and regulations may also be accorded this rating. Risk management practices are less than satisfactory relative to the institution's size, complexity, and risk profile. Institutions in this category generally give cause for regulatory concern and require more than normal supervision to address deficiencies. Overall strength and financial capacity, however, still make failure only a remote possibility if corrective actions are implemented.

Rating 4 — Institutions in this group have an immoderate number of serious financial or operating weaknesses. Serious problems or unsafe and unsound conditions exist that are not being satisfactorily addressed or resolved. Unless effective actions are taken to correct these conditions, they are likely to develop into a situation that will impair future viability or constitute a threat to the interests of investors, borrowers, and stockholders. Risk management practices are generally unacceptable relative to the institution's size, complexity, and risk profile. A potential for failure is present but is not yet imminent or pronounced. Institutions in this category require close regulatory attention, financial surveillance, and a definitive plan for corrective action.

Rating 5 — This category is reserved for institutions with an extremely high, immediate or near-term probability of failure. The number and severity of weaknesses or unsafe and unsound conditions are so critical as to require urgent external financial assistance. Risk management practices are inadequate relative to the institution's size, complexity, and risk profile. In the absence of decisive corrective measures, these institutions will likely require liquidation or some form of emergency assistance, merger, or acquisition.

Federal Agricultural Mortgage Corporation (Farmer Mac) — Farmer Mac was created with the enactment of the Agricultural Credit Act of 1987 to provide a secondary market for agricultural real estate and rural housing mortgage loans.

Federal Farm Credit Banks Funding Corporation (Funding Corporation) — The Funding Corporation, based in Jersey City, New Jersey, manages the sale of Systemwide debt securities to finance the loans made by Farm Credit System institutions. The Funding Corporation uses a network of bond dealers to market its securities.

Federal Intermediate Credit Bank (FICB) — The Agricultural Credits Act of 1923 provided for the creation of 12 FICBs to discount farmers' short- and intermediate-term notes made by commercial banks, livestock loan companies, and thrift institutions. The Farm Credit Act of 1933 authorized farmers to organize Production Credit Associations (PCAs), which could discount notes with FICBs. As a result, PCAs became the primary entities for delivery of short- and intermediate-term credit to farmers and ranchers. On July 6, 1988, the FICB and the Federal Land Bank in 11 of the 12 Farm Credit districts merged to become Farm Credit Banks. The mergers were required by the Agricultural Credit Act of 1987.

Federal Land Bank (FLB) — The Federal Farm Loan Act of 1916 provided for the establishment of 12 FLBs to provide long-term mortgage credit to farmers and ranchers, and later to rural home buyers. On July 6, 1988, the FLB and the Federal Intermediate Credit Bank in 11 of the 12 Farm Credit districts merged to become Farm Credit Banks. The mergers were required by the Agricultural Credit Act of 1987.

Federal Land Bank Association (FLBA) — FLBAs were lending agents for Farm Credit Banks. FLBAs made and serviced long-term mortgage loans to farmers and ranchers, and rural residents for housing. FLBAs did not own loan assets, but made loans only on behalf of the Farm Credit Bank with which they were affiliated. As of October 1, 2000, there were no remaining FLBAs.

Federal Land Credit Association (FLCA) — An FLCA is a Federal Land Bank Association that owns its loan assets. An FLCA borrows funds from a Farm Credit Bank to make and service long-term loans to farmers, ranchers, and rural residents for housing.

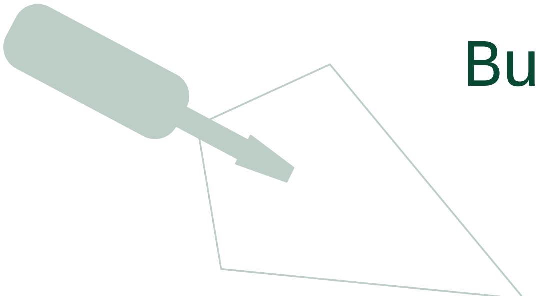
G

Government-Sponsored Enterprise (GSE) — A GSE is a federally chartered corporation that is privately owned, designed to provide a source of credit nationwide, and limited to servicing one economic sector. Each GSE has a public or social purpose: to improve credit to agriculture, education, or housing. GSEs are usually created because the private markets did not satisfy a purpose that the Congress deems worthy — either to fill a credit gap or to enhance competitive behavior in the loan market. Each is given certain features or benefits, referred to as GSE attributes, to allow it to overcome the barriers that prevented purely private markets from developing. Sometimes the public assistance is only to get started; at other times it is ongoing.

P

Production Credit Association (PCA) — PCAs are Farm Credit System entities that deliver only short- and intermediate-term loans to farmers and ranchers. A PCA borrows money from its Farm Credit Bank to lend to farmers. PCAs also own their loan assets.

Commitment to the community is important to FCA and its employees. In the spring of 2001, the Agency donated 79 laptop computers and 14 printers to schools identified by the Equal Employment Opportunity Commission as having special needs. An additional 53 laptops and 4 printers were donated to schools nominated by Agency staff as recipients. Chairman Reyna presented 10 of the laptops and a printer to the Langston Hughes Middle School in Reston, Virginia.



Building A Better Workplace. . .

The strength of America's agriculture is one of the foundations of the country, and a major building block for the nation's continued strength.

As the financial regulator of the Farm Credit System, FCA is a key element in ensuring that there is a dependable source of credit for agriculture and rural America.

The Farm Credit Administration helps build and protect a solid foundation for America, and for the bright, ambitious, and dedicated men and women who work with us. The 271 people who work at our offices across the country are proud to be part of a financial institution regulator that offers challenging and rewarding work.

We are a diverse group of people with a wide range of education and work experience, including finance, agricultural economics, regulatory development and bank examination, government, business administration, computer sciences, law, administrative services, accounting, and human resources.

The Agency offers a unique combination of competitive salaries and Federal government and Agency benefits that help employees build a solid career and a rewarding and flexible future.

- Alternative work schedules that allow full-time employees and their managers to set a work schedule that helps the staff member balance work and family needs.
- Flexible and compressed work schedules that let staff members work nine or 10 hours per day so they can have a "flex day off."
- A flexible time band that allows employees, with their manager's approval, to choose the start and end times for their workday.
- Flexitour, which lets staff change the start time of their workday, with their supervisor's approval.
- With a manager's approval, an employee may earn credit hours, which can be used when accommodating work and family responsibilities.
- Employees can earn compensatory time, with supervisor's approval, when they work overtime.
- A Flexiplace Program that lets employees work from home, with supervisory approval. Some staff members telecommute to avoid a long commute, while others work from home during bad weather.
- FCA provides a monthly transit subsidy for employees who use public transportation.
- Staff members select from a wide range of Federal government health insurance plans to meet their needs. FCA pays part of the insurance premium.
- Reimbursement of up to $150 for annual physical exams and preventative tests.
- A fitness center in the McLean, Virginia, headquarters.
- The Agency sponsors health and fitness programs to encourage healthier living.
- An Employee Assistance Program for short-term crisis counseling and guidance for employees and their families.
- On-site defibrillators.
- Subsidized flu shots.

. . .A Solid Foundation for the Future

- Business casual dress at the office.
- A childcare subsidy of up to 30 percent, depending on family income.
- Cash and time-off incentive awards for exceptional work.
- Individual Development Plans created by employees and supervisors to plan career goals and maximize training opportunities.
- A pre-tax Flexible Spending Account to help employees save money for health care or child care. This year, FCA contributed $750 to each employee's account.
- Competitive salaries.
- Full and part-time job opportunities.
- Employees may participate in the Federal Government group life insurance program.
- Employees may participate in the Federal government's Thrift Savings Plan, a tax- deferred savings and investment program, to help them build their retirement savings.
- Free long-term disability insurance.
- Federal government retirement programs that provide annuities and death benefits to help employees' protect their future.
- FCA follows the Office of Personnel Management (OPM) annual leave policy, which includes 10 paid Federal holidays each year.
- The Agency also follows the OPM sick leave policy. Full-time employees earn four hours of sick leave every two weeks.
- Staff may participate in the FCA Leave Bank that lets them donate annual leave to a general pool for use by other employees in case of family or personal medical emergencies.
- Participation in the Federal Leave Transfer Program, which lets staff donate annual leave to other Federal government employees for medical emergencies.

Employees of the Farm Credit Administration

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A final word of thanks to our employees, whose dedication to excellence and hard work made the accomplishments reported here possible.

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Additional Information

The *Farm Credit Administration Performance and Accountability Report Fiscal Year 2001* is now available on FCA's Web site at www.fca.gov. Depending on availability, printed copies of this publication may be obtained without charge from

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The Federal Farm Credit Banks Funding Corporation prepares the financial press releases, the *Report to Investors of the Farm Credit System*, the System's Annual and Quarterly Information Statements, and the System's combined financial statements contained therein, with the support of the System banks. Copies are available on the Funding Corporation's Web site at www.farmcredit-ffcb.com or from

Federal Farm Credit Banks Funding Corporation
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The Farm Credit System Insurance Corporation publishes an annual report. Copies are available on FCSIC's Web site at www.fcsic.gov or from

Farm Credit System Insurance Corporation
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In addition, FCS banks and associations are required by regulation to prepare annual and quarterly financial reports. Copies of these documents are available for public inspection at FCA headquarters in McLean, Virginia.

Copies Are Available From:
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