Farm Credit Administration

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

Performance and Accountability Report

Fiscal Year 2002

Contents

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Statement of the Chairman and CEO

January 2003

My Fellow Citizens,

On behalf of my colleagues on the Farm Credit Administration Board of Directors and the men and women of this agency, I invite you to review our fiscal year 2002 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 its 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 50 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 2002, 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. Our examinations have concluded that the System and each of its institutions are fundamentally sound in all material respects. The System has knowledgeable and experienced managers at all levels and year-over-year earnings are up.

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

Foreword

The FY 2002 Annual Performance and Accountability Report for the Farm Credit Administration (FCA or agency) is designed to meet the reporting requirements as established by the Office of Management and Budget (OMB), and to report on the financial condition and performance of the institutions within the Farm Credit System. As such, the report consolidates the reporting requirements for the Chief Financial Officers Act of 1990, the Federal Managers' Financial Integrity Act of 1982, the Government Management Reform Act of 1994, the Government Performance and Results Act of 1993, and the Reports Consolidation Act of 2000. It also reports on FCA's performance in ensuring that the operations of the System institutions are safe and sound.

The report has been organized in a manner that facilitates the dissemination of information to all of our customers, including Congress, OMB, the FCS, other stakeholders, and the public. The specific information requirements of OMB are located throughout the report. To facilitate the location of these requirements, please see pages 3, 7–9, 35–39, 46–70, and 76–79, which relate to Management's Discussion and Analysis of the FCA, its operations, and financial condition. FCA's annual program performance information, as required by the Government Performance and Results Act of 1993, is presented on pages 58 through 68. The performance report measures the agency's effectiveness in fulfilling its mission and accomplishing its goals. From a financial standpoint, FCA's financial performance is presented on pages 72–75, and 80–102. This section of the report includes the agency's year-end financial statements and the related auditor's reports, and the Inspector General's summary and progress assessment of serious management and performance challenges facing the agency.

We are again proud to report that the FCA has achieved an unqualified audit opinion for FY 2002—the ninth consecutive year. We hope that while you read this report, you are mindful of the efforts that have been made by the FCA to continuously improve its program and financial performance as it works to ensure that the institutions within the FCS remain financially strong and focused on their mission.

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

Farm Credit Administration Organization and Mission

The Farm Credit Administration is an independent agency within 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, and agricultural and rural utility cooperatives.

Originally created by a 1933 executive order of President Franklin D. Roosevelt, today's FCA derives its powers and authorities from the Farm Credit Act of 1971, as amended (Farm Credit Act or Act). The U.S. Senate Committee on Agriculture, Nutrition, and Forestry and the U.S. House of Representatives Committee on Agriculture oversee the FCA and the FCS.

FCA's mission 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 examinations of Farm Credit System institutions 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. Second, 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 its operations are unsafe or unsound, FCA may use its enforcement authority to ensure that the problem is corrected. FCA also protects the rights of borrowers, issues and 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 maintains 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 its regulatory agenda are established by a full-time, three-person Board, whose members are appointed by the President of the United States with the advice and consent of the Senate. They serve six-year terms and may not be reappointed after serving full terms or more than three years of previous members' terms. The President designates one member as Chairman of the Board, who serves until the end of his own 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 Bill 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.

Mr. Reyna served as a principal advisor to the California State Legislature for 11 years, working on a wide range of issues, including financial service industry regulation, housing, economic development, local government finance, and political reform. He was appointed to serve on several local commissions, including the Sacramento City Planning Commission, of 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 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 expired May 21, 2002.[1] 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.

Ms. Jorgensen brings four decades of experience in production agriculture and accounting to her position. 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 her native 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 coauthor of a producer's guide, *The Farmer's Guide to Total Resource Management,* and 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 important 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.

Ms. Jorgensen holds a B.A. from the University of Iowa.

1. Although Ann Jorgensen's term expired in May 2002, she remained on the Board until November 18, 2002. Her successor, Nancy C. Pellett, was sworn in on November 27, 2002.

Douglas L. "Doug" Flory

Board Member

Douglas L. "Doug" Flory was appointed to the three-member FCA Board by President George W. Bush on August 1, 2002, for a term that expires October 13, 2006. He also serves as a Member of the Board of Directors of the Farm Credit System Insurance Corporation.

Mr. Flory brings extensive experience in production agriculture, agribusiness, and commercial bank and Farm Credit lending to his position on the FCA Board. His farming operation includes Bunker Hill Farm, which annually produces 120,000 tom turkeys. He is also 50 percent owner of S & F, L.L.C., a general livestock, grain, and hay farm covering 1,300 owned and leased acres in Virginia's Augusta County.

Before his appointment to the FCA Board, Mr. Flory was a member of the board of directors of AgFirst Farm Credit Bank in Columbia, South Carolina, and a director of Farm Credit of the Virginias, ACA, in Staunton, Virginia. He also served as a member of the Farmer Mac Appraisal Standards Committee.

He was executive vice president of Dominion Bank from 1971 to 1988, and also president, CEO, and director of Dominion Farm Loan Corporation. During his banking career, he chaired the Virginia Bankers Association Committee on Agriculture and was a member of the Executive Committee of the American Bankers Association's agricultural division. From 1989 to 1992, he was executive vice president, chief operating officer, and a member of the board of WLR Foods, Inc., a publicly traded poultry food company (now part of Pilgrims Pride).

Mr. Flory has served on several governing boards for the Commonwealth of Virginia. He was appointed to the Virginia Agricultural Council, a state advisory board, and the Virginia Agriculture Credit Committee, which he chaired. He also served on the Virginia Agricultural Development Authority, which uses "aggie bonds" to finance Virginia farmers.

Mr. Flory has been an active participant in agriculture industry associations. He has served as president of the Virginia Turkey Association and as president and director of the Rockingham County Fair Association. He also served as a director of the Virginia Poultry Federation, the Virginia Agribusiness Council, the Virginia Beef Cattle Association, and the Virginia Sheep Association.

Mr. Flory, a native of Augusta County, Virginia, attended Bridgewater College in Bridgewater, Virginia, and earned a bachelor's degree from Virginia Polytechnic Institute and State University in Blacksburg. He did graduate work at James Madison University and is a graduate of the Maryland–Virginia School of Bank Management at the University of Virginia.

FCA — The Agency

The 276 full- and part-time employees[2] of the Farm Credit Administration work together to ensure that the Farm Credit System remains a dependable source of credit for agriculture and rural America. In summertime, they are supported in FCA's offices by interns who gain valuable government and business experience.

The following paragraphs explain the role of each of the agency's offices.

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 plans, organizes, and directs 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.

2. As of September 30, 2002.

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.

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.

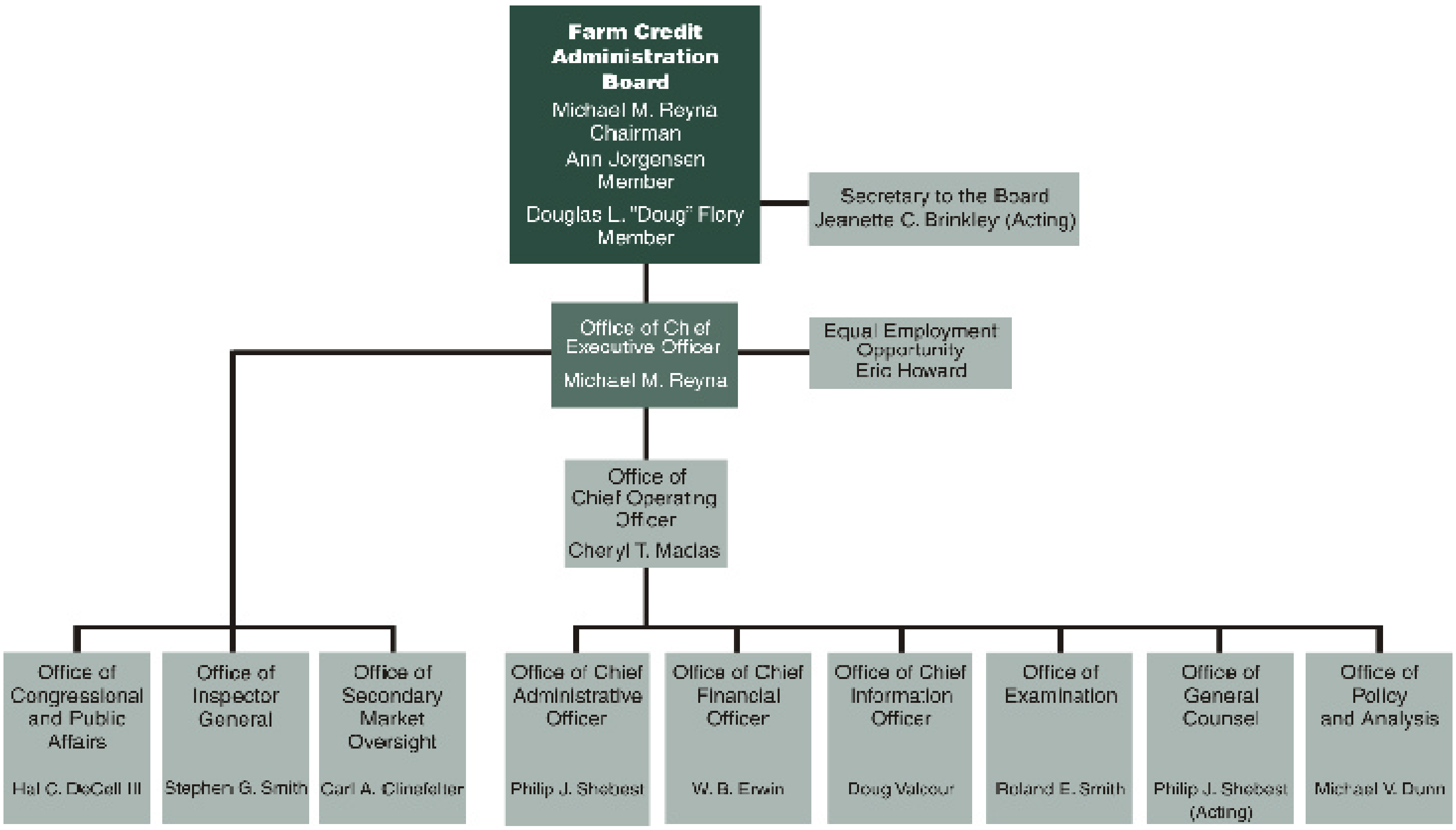
The Office of Chief Financial Officer provides financial services to the agency, including financial systems operations, periodic financial reports, and the processing of payments to vendors.

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 directs 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.

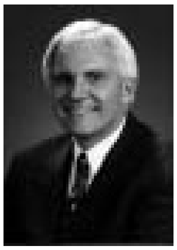
Figure 1 shows FCA's organizational structure as of September 30, 2002.

Figure 1
Farm Credit Administration Organizational Structure
As of September 30, 2002



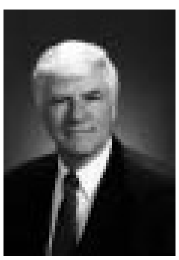
Agency Officials

Jeanette C. Brinkley is Acting Secretary to the FCA Board.[3] She joined FCA in November 1982 as secretary in the Office of Administration. During her tenure with FCA, Ms. Brinkley has worked in the Office of Examination and Supervision, the Office of Congressional and Public Affairs, and the Office of Chief Operating Officer. In 1995, she began working for the Office of the Board as the administrative specialist to the Secretary to the FCA Board.



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 Office of Supervision, as an associate regional director in the Office of Examination and Supervision, and as acting director of the 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 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, Nebraska, 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 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 of the Office of Policy and Analysis in 1997.

3. Ms. Brinkley replaces Kelly Mikel Williams, who served as Secretary to the Board from July 2, 2000, until his resignation on October 4, 2002.

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, where she served as 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, during which she served as the senior member of the domestic issues staff for the House Select Committee on Hunger.

Philip J. Shebest is the Chief Administrative Officer and Acting General Counsel. He joined FCA in 1990 as a senior attorney in the Office of General Counsel. Mr. Shebest became the director of the Human and Administrative Resources Division in 1996 and in 2000 was selected as Chief Administrative Officer. 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 of the 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 Farm Credit System in 1974 as a loan officer for the Production Credit Association in Greenville, North Carolina. He later served as a loan officer and credit reviewer for the Farm Credit Banks of Columbia, South Carolina.

Stephen G. Smith became the Inspector General in January 2001. 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 is the Chief Information Officer. He joined FCA in 1988 as a computer specialist in the Office of Resources Management. In 1990, he became chief of the Systems Development Branch, and he was named associate director of the Information Resources Division and team leader of the Technology Team in 1997. Before joining FCA, Mr. Valcour was a computer specialist for the U.S. Department of Energy from 1986 until 1988. From 1983 to 1986, he was a computer programmer and analyst for the Veterans Administration.

Farm Credit System — An Overview of Events and Conditions

FCS Function and Structure

The Farm Credit System 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, 2002, the System was composed of 111 banks and associations. Seven Farm Credit banks provide loan funds to 81 Agricultural Credit Association (ACA) parent organizations,[1] three ACAs, four Production Credit Associations (PCAs), and 16 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.

The Federal Agricultural Mortgage Corporation[2] 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

1. 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.
2. 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 Farm Credit Administration through the Director, Office of Secondary Market Oversight, who reports to the FCA Board for policy.

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:[3]

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 7 of the 13 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.

3. 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.

When Congress established the FCS as a GSE, its purpose was to provide a permanent, reliable source of credit and related services to agriculture 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.

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, as well as rural home purchasers.

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 its borrower stockholders.

The sections in this chapter first assess the System's financial strength and then its service to rural America. Our 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 ranchers, and use of government guarantee programs in supporting loans to farmers not able to meet normal underwriting requirements.

Financial Condition of the FCS[1]

Farm Credit System loan volume increased sharply for the second consecutive year (see below "Borrowers Served"). Nonaccrual loans also increased over the 12 months ended September 30, 2002, but overall loan quality remained high. Interest rates were at 40-year lows throughout the last year, ensuring low interest expense. Continued high levels of government payments to the agricultural sector supplemented borrower incomes (see pages 40–45 for a discussion of risks to the rural economy). The combination of low interest rates, increasing loan volumes, and generally strong borrower repayments resulted in increased net income.

1. 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 the FCA or to the Federal Farm Credit Banks Funding Corporation. The analysis in this report is based on publicly available information and, except where noted, is based on the 12-month period ended September 30, 2002. See Tables 2 and 3 on pages 22 and 23, respectively, for System measures of financial condition.

Asset Quality

Loan volume continued to grow and loan quality remained high for the year ended September 30, 2002. Gross loans increased 9.8 percent to $87.9 billion. Non-performing loans[2] increased to 1.4 percent of total loans compared with 1.2 percent a year earlier. Nonaccrual loans were 1.1 percent of total loans compared with 1.0 percent a year earlier (see Figure 2). The increase was due to declining credit quality in several loans to agribusiness cooperatives and communication and energy companies. At September 30, 2002, the allowance for loan losses represented 172 percent of nonperforming loans and 2.32 percent of total loans compared with 216 percent and 2.54 percent a year earlier. Delinquencies (accrual loans more than 90 days past due) remained minimal.

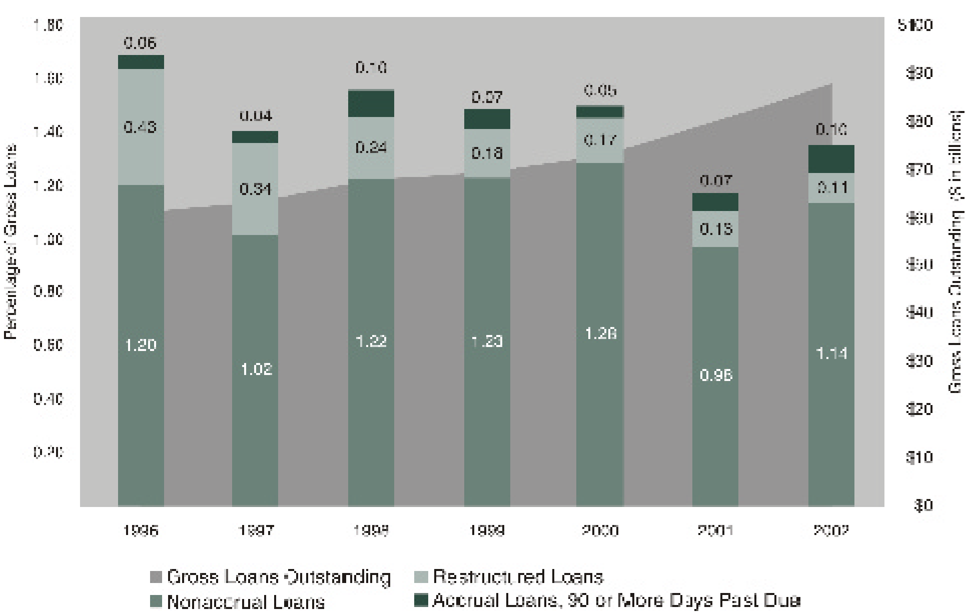
Earnings

The System's $1.4 billion in net income for the nine months ended September 30, 2002, was up $76 million from the same period the previous year. Net interest margins were stable with a Systemwide net interest margin of 2.76 percent as of September 30, 2002, compared with 2.79 percent a year earlier. Noninterest expenses for the first nine months of 2002 were higher than for the same period in 2001, but, because loan volume increased, the ratio of noninterest expenses to total loans fell. Noninterest income for the first nine months of 2002 was $270 million compared with $281 million for the same period last year.

Figure 2

Farm Credit System Nonperforming Loans Increase

As of September 30



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

2. Nonperforming loans consist of nonaccrual loans, restructured loans, and accrual loans 90 or more days past due.

FCA Board: Listening to the Public

The Farm Credit Administration works to ensure the availability of dependable and affordable credit to agriculture and rural America today and for future generations. In November, the FCA Board held a public meeting in Kansas City, Missouri, to gather ideas on ways to enhance the Farm Credit System's service to young, beginning, and small farmers, ranchers, and producers or harvesters of aquatic products (YBS farmers and ranchers).

At the meeting, FCA Chairman Michael M. Reyna, and Board Members Douglas L. "Doug" Flory and Ann Jorgensen heard from a diverse group of speakers, including small farmers, agricultural lenders, farm advocates, FCS borrowers, academics, and government officials. While those testifying agreed that YBS farmers and ranchers need greater access to credit and capital, the recommendations ranged from no modifications of existing regulations to suggestions that would require changes to the Farm Credit Act. The testimony presented at the meeting is posted on FCA's Web site at www.fca.gov.

Provisions for income taxes for the first nine months of 2002 were $68 million, up $49 million from the same period in 2001 due to increased earnings and smaller tax refunds. Substantially all expected tax refunds have now been recognized.

Capital[3]

The System continues to build capital through increased loan volume and earnings. Total capital ($17.0 billion) as a percentage of total assets ($107.5 billion) increased proportionally to loan growth and remained at 15.8 percent as of September 30, 2002 (see Figure 3). Accumulated surplus alone now represents more than 12.5 percent of System assets and 79 percent of total capital.

Permanent capital ratios (PCRs) at System associations ranged from a low of 10.5 percent to a high of 28.1 percent—all well above the 7.0 percent regulatory minimum. Ninety percent of System associations had PCRs of at least 12.8 percent. For System banks, PCRs ranged from 12.1 percent to 21.8 percent. All banks and associations exceeded their minimum regulatory core surplus and total surplus ratio requirements (3.5 percent and 7.0 percent, respectively) at September 30, 2002.

Funding

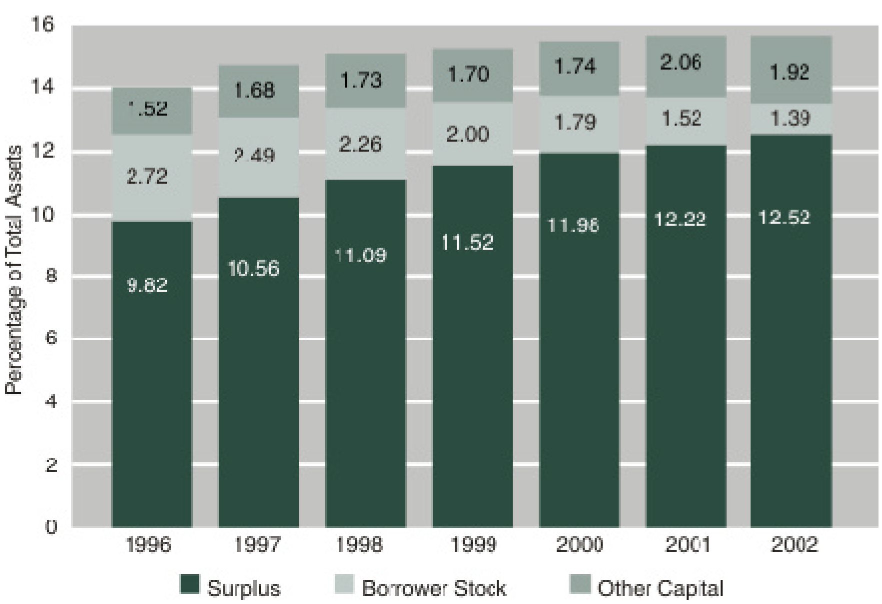
The System funds its loans with a combination of consolidated Systemwide debt and capital. The par value of outstanding Systemwide debt increased by $7.0 billion (8.8 percent) while gross loans outstanding increased by $7.8 billion (9.8 percent). Capital increased by $1.4 billion, which was used to fund the rest of the loans as well as additional investments.

Due to falling interest rates in 2001, the System was able to retire and reissue substantial portions of its callable debt, resulting in high levels of debt securities issuance during 2001 and early 2002. Since then, the rate of reissuance has declined. For the 12 months ended September 30, 2002, the System issued

Figure 3

Farm Credit System Capital Increases as a Percentage of Total Assets, 1996–2002

As of September 30



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

3. 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. Restricted Capital ($1.8 billion at September 30, 2002) 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 was a negative $36 million at September 30, 2002. One System bank had $231 million outstanding of Mandatorily Redeemable Term Preferred Stock and Accumulated Dividends. Such stock is not included in "Total Capital" though it qualifies for certain regulatory capital purposes. Protected Capital ($38 million at September 30, 2002) 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.

Table 1

Farm Credit System Gross Loans Outstanding, 1997–2002

As of September 30

Dollars in Millions

Loan Category	1997	1998	1999	2000	2001	2002	Percentage Change from 1997
Long-Term Real Estate[1]	$30,346	$32,009	$34,218	$35,549	$39,722	$44,782	47.6
Short- and Intermediate-Term[2]	16,474	18,162	18,616	18,917	21,397	23,328	41.6
Domestic Cooperatives[3]	14,053	13,768	14,549	15,908	16,298	16,774	19.4
International	2,128	2,171	2,274	2,583	2,679	3,033	42.5
Total	**$63,001**	**$66,110**	**$69,657**	**$72,957**	**$80,096**	**$87,917**	**39.5**

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 Statements, Third Quarter.

$448 billion in insured debt securities[4] compared with $517 billion for the prior 12 months. The System's average remaining maturity for all outstanding insured debt was essentially unchanged at around 1.8 years for both September 30, 2002, and September 30, 2001. However, the weighted average yield for the insured debt dropped dramatically from 4.75 percent at September 30, 2001, to 3.35 percent at September 30, 2002.

Borrowers Served

The System fulfills its overall mission by fully utilizing its authority to lend to agriculture and rural America. 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 $87.9 billion in gross loans outstanding as of September 30, 2002 (see Table 1). Agricultural producers represented by far the largest borrower group with $68.1 billion, or more than three-quarters of the total dollar amount of gross loans outstanding.[5] As required by law, all borrowers are also stockholder-owners of System institutions. The System has more than 670,000 loans and about 450,000 stockholders. About 85 percent of the stockholders 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 (50.9 percent) was in long-term real estate loans, 26.5 percent in short- and intermediate-term loans to agricultural producers, and 19.1 percent to cooperatives. International loans (export financing) represented 3.5 percent of the System's loan portfolio. Rural

4. Consolidated Systemwide debt securities are insured by the Farm Credit System Insurance Corporation's Farm Credit Insurance Fund. A small amount of outstanding Farm Credit System debt, $481 million at September 30, 2002, was issued by individual banks of the Farm Credit System. These individual banks are solely liable for this uninsured debt.
5. Some of this total consists of loans to rural homeowners and leases.

home loans made up about 2.3 percent of total loans (these are part of long-term real estate loans in Table 1). Loans to finance rural utilities (included in cooperative loans) comprised $6.9 billion or about 8 percent of overall loan volume; this segment has roughly doubled 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 gross loan dollars outstanding grew by $7.8 billion, or 9.8 percent, during the year ended September 30, 2002, and by $24.9 billion, or 39.5 percent, over the past five years. Volumes in all loan categories were above both the year-earlier and the five-year ago levels. Total members served increased about 3 percent during the past year. About 70 FCS associations had double-digit loan volume growth, and only four associations had a drop in loan volume for the year ended September 30, 2002. With lending growth occurring throughout the country, the System continues to show a strong commitment to its mission of service to agriculture and rural America.

The System's increased loan volume over the past 12 months stems mainly from long-term real estate loans (up $5.1 billion or 12.7 percent) and short- and intermediate-term loans (up $1.9 billion or 9.0 percent). The fastest growing components of short- and intermediate-term lending continue to be "other," farm-related business, and marketing and processing loans, which surpassed the growth rate for the largest component of the short- and intermediate-term loan category, nonreal estate agricultural loans. Loan participations purchased from non-System lenders continued as another source of loan growth (up 19 percent over the 12 months ended September 30, 2002). However, lease receivables did not grow this year (down nearly 9 percent for the Leasing Corporation over the recent 12 months).

Several factors have facilitated the System's strong loan growth. The funding environment has allowed the System to offer favorable interest rates, and the institutions have mounted effective marketing campaigns. Mergers among System institutions have also allowed them to market a wider array of services and products. With strong capital positions, a number of System institutions have used participation loans, both within and outside the System, as a way of utilizing their capital base while achieving portfolio diversification and risk reduction. At the same time, slow growth in agricultural lending by commercial banks suggests that many have either decided to reduce their exposure to the risk of agricultural lending or they have found more attractive financing opportunities in other types of commercial lending. Mergers among commercial banks may have caused some to focus on sectors and communities outside the rural service areas where some of the merger partners originated.

Funding for Other Lenders

Other Financing Institutions

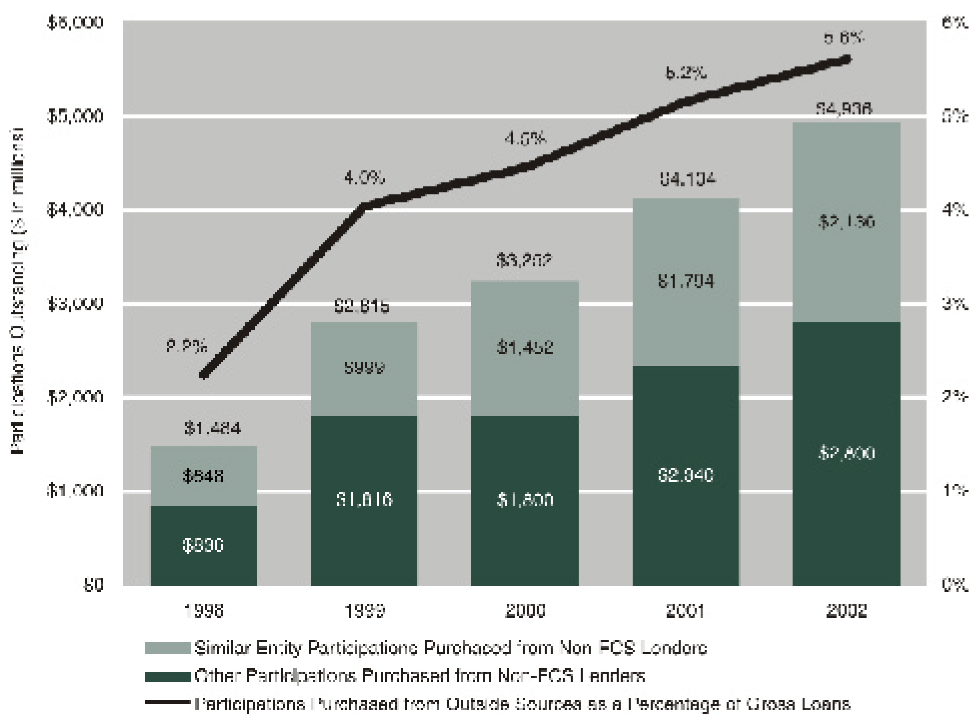
Under the Farm Credit Act, System banks can further serve the credit needs of rural America by providing funding and discounting services to non-System lending institutions known as "other financing institutions" (OFIs). OFIs include commercial banks, thrifts, credit unions, trust companies, agricultural credit corporations, and other specified agricultural lenders. System banks can fund and discount short- and intermediate-term loans for OFIs that are significantly involved in lending to agricultural and aquatic producers and demonstrate a need for additional funding to meet the credit needs of eligible borrowers. Over the past five years, the number of OFIs has increased from 26 to 30 and the loan volume has risen from $232 million to $300 million, representing increases of 15 and 29 percent, respectively. While System loans to OFIs have increased, they represented just 0.4 percent of System loans to producers as of September 30, 2002.

Participations with Outside Sources Continue to Rise

System banks and associations have authority to participate (purchase or sell an interest in a loan) with commercial banks or other financial institutions in making loans to agriculture and rural America. Financial institutions use loan participations primarily to reduce interest rate and credit risk, but they also are used to enhance liquidity, earnings, and capital. Agricultural lenders with high commodity concentrations frequently use participations to reduce risk through portfolio diversification or to serve customers better by funding large loans when they have insufficient capital.

Participations purchased from outside sources by System institutions have increased sharply in recent years, rising from $1.5 billion as of September 30, 1998, to $4.9 billion by September 30, 2002, an increase of nearly $3.5 billion or 233 percent (see Figure 4). In just the past year, participations have risen $802 million or 19 percent. The growing importance of participations to the System is also reflected by their increasing share of total gross loans, a ratio that has risen from 2.2 percent as of September 30,

Figure 4
Participations Steadily Increase as FCS Works Closer with Non-FCS Lenders
As of September 30

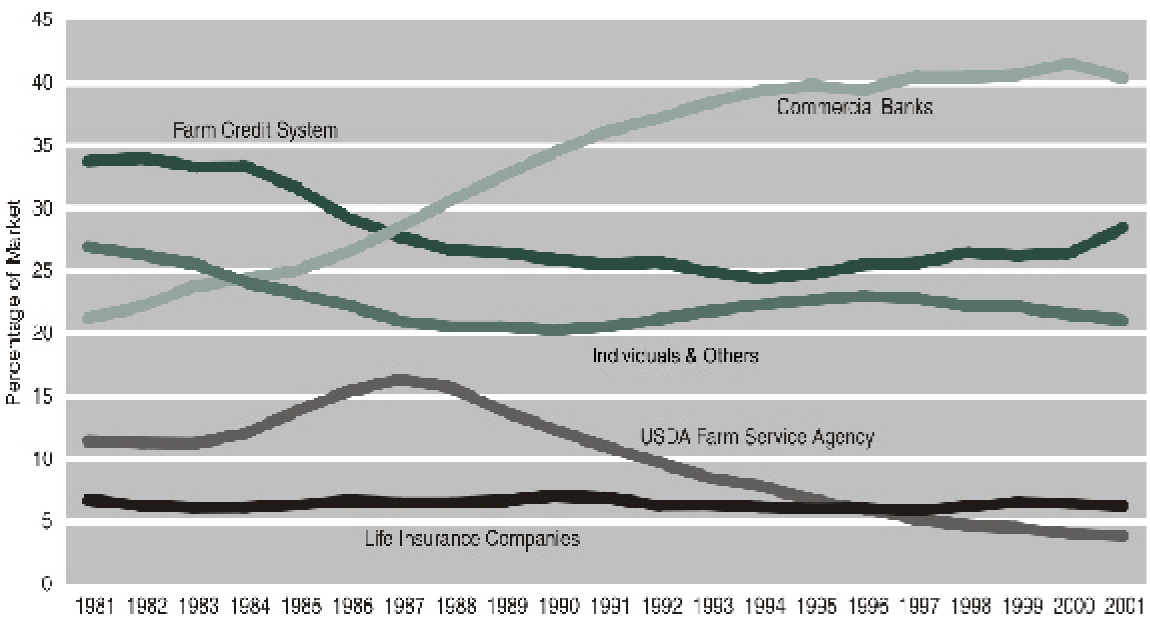


Source: Call Reports received from the Farm Credit System and Quarterly Information Statements.

Figure 5

Total Farm Business Debt, Market Shares, 1980-2001

As of December 31



Note: "Individuals & Others" includes trade credit, seller financing of real estate, Commodity Credit Corporation storage and drying facility loans, and loans sold to Farmer Mac.
Source: USDA, Economic Research Service: Agricultural Income and Finance Outlook Report, AIS-79, September 2002.

1998, to 5.6 percent as of September 30, 2002. Through the expanded use of participations, the System is helping other lenders meet the credit needs of agriculture and rural America, yet another way in which the System carries out its mission.

FCS Market Share of Farm Debt

Following a year of rapid growth, the Farm Credit System's December 31, 2001, share of total farm debt jumped from 26.4 percent at year-end 2000 to 28.3 percent (see Figure 5).[6] The System's market share of total farm debt reached a low of 24.4 percent in 1994, following a high of 34.0 percent at year-end 1982. Over the past five years, both the System and commercial banks have generally had small gains in market share. Market share for individuals and others as well as USDA's Farm Service Agency (FSA) direct lending has declined. Meanwhile, the market share for life insurance companies has remained relatively stable. Although commercial banks continued to have the largest market share during 2001, they had their largest decline in share in two decades, dropping 1.1 percentage points to 40.5 percent. Market shares held by individuals and others, FSA, and life insurance companies declined slightly.

As of year-end 2001, the System held 34.2 percent of the market in real estate secured farm debt, up 1.7 percentage points during the year. In the nonreal-estate market, the System held 21.5 percent, which was up 2.1 percentage points during the year. Year-end 2002 loan volume and market share estimates were not available for this report, but FCS information through the third quarter showed continued strong growth in volume of loans to farmers. Meanwhile, commercial banks' total loans to farmers were up one percent for the year ended June 30, 2002. This suggests that the System may again have gained market share in both the long- and short-term markets in 2002.

6. 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. Market share information is not routinely available on the nonfarmer segments of the System's lending activity—namely, its loans to rural homeowners, marketing and processing firms, rural utilities, and the financing of international farm commodity sales.

Table 2

Farm Credit System Major Financial Indicators

Year to Date as of September 30

Dollars in Thousands

Farm Credit System Banks[1]	2002	2001	2000	1999	1998
Gross Loan Volume	$78,644,139	$72,046,891	$65,967,226	$63,920,055	$60,992,400
Accruing Restructured Loans[2]	$433,659	$356,916	$179,596	$202,910	$280,708
Accrual Loans 90 or More Days Past Due	$41,731	$18,529	$11,539	$15,321	$35,902
Nonaccrual Loans	$411,164	$236,356	$493,983	$438,057	$469,550
Nonperforming Loans/Gross Loans[3]	1.13%	0.85%	1.04%	1.03%	1.29%
Cash and Marketable Investments	$15,833,066	$15,266,188	$14,361,173	$13,389,314	$12,678,099
Capital/Assets[4]	7.04%	7.51%	7.55%	7.80%	8.38%
Unallocated Retained Earnings/Assets	3.95%	3.89%	4.01%	3.99%	4.06%
Net Income	$575,863	$487,314	$438,813	$379,919	$482,574
Return on Assets[5]	0.82%	0.74%	0.73%	0.66%	0.88%
Return on Equity[5]	11.06%	9.48%	9.55%	8.32%	10.32%
Net Interest Margin	1.18%	1.20%	1.21%	1.35%	1.45%
Operating Expense Rate[6]	0.35%	0.38%	0.41%	0.48%	0.46%
Associations Excluding Federal Land Bank Associations[7]					
Gross Loan Volume	$65,232,842	$57,482,274	$50,030,496	$42,759,760	$39,975,359
Accruing Restructured Loans[2]	$80,255	$86,714	$81,519	$74,164	$76,097
Accrual Loans 90 or More Days Past Due	$48,071	$36,535	$22,707	$38,502	$30,746
Nonaccrual Loans	$587,629	$545,193	$443,610	$418,474	$361,679
Nonperforming Loans/Gross Loans[3]	1.10%	1.16%	1.10%	1.24%	1.17%
Capital/Assets[8]	15.94%	16.38%	16.86%	16.40%	16.12%
Unallocated Retained Earnings/Assets	13.72%	13.98%	14.03%	13.14%	12.61%
Net Income	$780,488	$866,295	$639,383	$485,716	$526,556
Return on Assets[5]	1.57%	1.94%	1.64%	1.44%	1.66%
Return on Equity[5]	9.70%	11.98%	9.73%	8.78%	10.29%
Net Interest Margin	2.72%	2.86%	2.98%	3.05%	3.16%
Operating Expense Rate[6]	1.41%	1.47%	1.57%	1.65%	1.63%
Total Farm Credit System[9]					
Gross Loan Volume	$87,917,000	$80,096,000	$72,957,000	$69,657,000	$66,110,000
Accruing Restructured Loans[2]	$98,000	$105,000	$123,000	$127,000	$161,000
Accrual Loans 90 or More Days Past Due	$90,000	$55,000	$34,000	$52,000	$66,000
Nonaccrual Loans	$1,000,000	$781,000	$937,000	$857,000	$831,000
Nonperforming Loans/Gross Loans[3]	1.35%	1.17%	1.50%	1.49%	1.60%
Bonds and Notes	$87,913,000	$80,974,000	$74,369,000	$70,902,000	$67,651,000
Capital/Assets[10]	15.83%	15.80%	15.52%	15.23%	15.17%
Surplus/Assets	12.52%	12.22%	11.98%	11.52%	11.09%
Net Income	$1,371,000	$1,295,000	$1,048,000	$934,000	$1,008,000
Return on Assets[5]	1.75%	1.78%	1.57%	1.47%	1.68%
Return on Equity[5]	11.01%	11.41%	10.18%	9.72%	11.07%
Net Interest Margin	2.76%	2.79%	2.74%	2.75%	2.90%

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

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, 2002

Dollars in Thousands

	Total Assets	Gross Loan Volume	Nonaccrual Loans	Allowance for Loan Losses	Cash and Marketable Investments	Capital Stock[2]	Surplus[3]	Total Capital[4]
Farm Credit System Banks								
Wichita	$5,943,006	$4,765,044	$3,169	$31,230	$1,096,952	$123,300	$334,638	$464,091
Texas	6,378,205	5,718,156	26,036	14,271	619,739	105,341	249,875	355,204
Western	8,412,403	7,370,150	0	5,157	948,184	242,318	220,360	440,684
AgriBank	24,039,500	19,185,023	34,308	68,537	4,607,238	528,946	1,118,404	1,633,986
AgAmerica	10,866,967	9,317,102	9,540	8,407	1,438,780	344,029	395,287	677,523
AgFirst	13,831,518	11,822,363	33,892	25,155	1,837,616	285,005	568,329	856,246
CoBank	25,967,440	20,466,301	304,219	379,498	5,284,557	1,343,261	891,503	2,286,988
Total	$95,439,039	$78,644,139	$411,164	$532,255	$15,833,066	$2,972,200	$3,778,396	$6,714,722
Associations								
Wichita	$5,216,363	$5,051,709	$26,665	$156,291	$27,034	$50,759	$1,018,359	$1,071,742
Texas	6,396,893	6,266,558	42,390	153,646	7,430	103,342	927,185	1,030,527
Western	8,772,108	8,443,622	84,499	141,154	9,207	83,025	1,116,607	1,199,632
AgriBank	21,838,343	20,818,967	176,095	387,302	0	151,682	3,159,347	3,312,166
AgAmerica	11,018,065	10,520,372	148,387	317,066	47,075	46,331	1,680,310	1,744,320
AgFirst	11,960,534	11,598,599	85,741	275,537	12,229	171,640	1,754,088	1,941,760
CoBank	2,622,411	2,533,015	23,852	70,127	7,510	37,421	458,113	508,075
Total	$67,824,717	$65,232,842	$587,629	$1,501,123	$110,485	$644,200	$10,114,009	$10,808,222
Total Farm Credit System	$107,469,000	$87,917,000	$1,000,000	$2,044,000	$16,689,000	$1,493,000	$13,456,000	$17,017,000

1. Aggregations of district data may not equal totals due to eliminations.
2. Includes capital stock and participation certificates, excludes madatorily redeemable preferred stock and protected borrower capital.
3. Includes allocated and unallocated surplus.
4. Includes capital stock, participation certificates, perpetual preferred stock, surplus, accumulated other comprehensive income, and restricted capital (amount in the Farm Credit Insurance Fund, for Farm Credit System total only). Excludes mandatorily redeemable preferred stock and protected borrower capital.

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 federally chartered agricultural lending cooperatives, the institutions of the Farm Credit System are single-purpose lenders exposed to risk in making loans to benefit their borrower-shareholders and meet their public mission. While the FCS benefits from preferred access to the capital markets as a government-sponsored enterprise, the federal government does not subsidize it directly. For FCS institutions to maintain their presence in the marketplace as a dependable source of credit and related services for rural America, they must operate profitably as well as properly manage and control risk. Accordingly, FCA continues to deploy examination and supervisory resources based on the risk in each institution. This "risk-based" examination and supervisory program requires examiners to determine how certain existing or emerging issues facing an institution or the agriculture industry affect the nature and extent of risks in that institution. This includes evaluations of whether FCS institutions are complying with laws and regulations and meeting their public mission. Based on these evaluations, FCA examiners establish examination plans and actions.

To evaluate whether an institution is meeting its public mission, FCA 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.

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 the capital-intensive farming business 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 customers by assessing their long-term earnings potential and risk-management ability. Various state and federal programs provide interest rate reductions and/or guarantees to help commercial lenders and FCS institutions reduce credit risks and 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, to coordinate with other governmental programs, and to make a long-term commitment in lending to these groups.

Section 4.19 of the Farm Credit Act and FCA Regulation 614.4165 require each System bank and association board to have a program in place for furnishing sound and constructive credit and related services to young, beginning, and small farmers and ranchers. YBS programs are to be made available in coordination with other System institutions and other government and private sources of credit.

In addition, each institution is required to report yearly on operations and achievements under its YBS programs.

To provide additional guidance, the FCA Board in December 1998 adopted a policy statement (FCA-PS-75) 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 borrowers. To implement the policy statement and improve our ability to analyze and report on the System's service to all YBS borrowers, we issued a Bookletter to the System in December 1998 that provided new definitions and reporting procedures to be fully phased in by January 1, 2001.

During FY 2002, five significant events occurred that further underscored the agency's views on the importance of the System's mission to serve YBS farmers and ranchers. The first event was recognition by FCA of FCS institutions that had effective programs for serving the needs of YBS farmers and ranchers. The Farm Credit of Maine, ACA and Farm Credit Services Southwest, ACA were each presented with a "Chairman's Commendation" for having exemplary YBS programs.[1] Recognition was based on several criteria, including the extent to which the institution offers financial incentives, such as differential loan underwriting standards, lower fees or interest rates, special education programs, effective outreach programs, and participation with government-guaranteed lending programs, including USDA's Farm Service Agency (see page 30).

The second event occurred on March 8, 2002, when the U.S. General Accounting Office (GAO) issued a report on the FCA's oversight of the System's mission to serve YBS farmers and ranchers.[2] To strengthen FCA's oversight role of the System, promote YBS compliance, and highlight the System's efforts to provide service to YBS farmers and ranchers, GAO recommended that the FCA Board:

1. Promulgate a regulation that outlines specific activities and standards that constitute an acceptable program to implement the YBS statutory requirement,
2. Ensure that examiners follow the guidance and complete the appropriate examination procedures related to YBS and adequately document the work performed and conclusions drawn during examinations, and
3. Publicly disclose the results of examinations for YBS compliance for individual System institutions.

The FCA committed to address the recommendations contained in the GAO report.

The third event was the implementation of additional controls to provide assurance that examiners are fully completing the comprehensive YBS examination leadsheet. Prior to the GAO audit, examiners had been completing YBS examination procedures using a "risk-based" approach, focusing attention on those areas deemed to be significant to that particular institution. Shortly after receiving the GAO report, the "risk-based" approach was discontinued and comprehensive scope examinations became mandatory in all association examinations, with full supporting documentation of work performed. Senior examiners are required to provide close supervision of the YBS examination program, and quality assurance examiners review the work completed and certify that the examiners followed all applicable guidance. The GAO has subsequently reviewed our progress in this area and agreed that our corrective action plan adequately addressed the audit findings.

The fourth event was the enhancement of the agency's Web site in April 2002. The Web site now provides access to YBS loan volume data as reported annually to FCA by each System direct lender. Data are retrievable by institution, by district, and by the entire Farm Credit System.

The fifth event occurred in September 2002, when the agency sought public comment in its rulemaking process. Specifically, we sought public input on ways to: improve the development of

1. The associations were recognized during The Farm Credit Council 19th Annual Meeting in Orlando, Florida, on January 22, 2002.
2. "Farm Credit Administration: Oversight of Special Mission to Serve Young, Beginning, and Small Farmers Needs to be Improved," GAO-02-304, March 8, 2002.

Table 4

Loans Outstanding at December 31, 2001, Benefiting Young, Beginning, and Small Farmers and Ranchers[1]

Loan Type	Number of Loans	Percentage of Total Number	Volume of Loans ($ millions[2])	Percentage of Total Volume	Average Loan Size
Young Farmers and Ranchers	101,373	16.7	$8,631	12.0	$85,141
Beginning Farmers and Ranchers	128,012	21.1	$12,603	17.5	$98,452
Small Farmers and Ranchers, by Loan Size					
$50,000 or less	210,219	63.7	$ 4,099	61.9	$ 19,499
$50,001–$100,000	71,542	57.1	5,071	56.0	70,881
$100,001–$250,000	45,214	45.3	6,656	42.9	147,206
More than $250,000	11,161	22.0	5,190	12.7	464,987
Total Loans to Small	338,136	55.8	$ 21,016	29.1	$ 62,151

1. A young farmer is defined as 35 years old or younger when the loan is made; a beginning farmer has 10 years or fewer farming or ranch experience; a small farmer is one who typically generates less than $250,000 in annual sales of agricultural or aquatic products. 2001 is the first year of full reporting under new reporting requirements and definitions. Since the totals are not mutually exclusive, one cannot add across young, beginning, and small categories to count total YBS lending.
2. Figures rounded to the nearest thousandth.

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

guidelines for YBS programs, measure the System's YBS performance to ensure the System is fulfilling its statutory mission, and provide adequate reporting and disclosure to the public on the System's compliance with its YBS mission. Seeking public input is an important way to ensure that the FCS designs comprehensive YBS policies and programs that have a reasonable likelihood of success. (A public meeting was held in Kansas City, Missouri, on November 13, 2002.)

FCA encourages System institutions to evaluate their performance in YBS lending by analyzing their lending markets and assessing their own market penetration. If this assessment suggests that an association needs to penetrate the YBS market further, we encourage its board to develop new programs, strengthen existing programs, or provide added incentives to contribute to the success of its marketing programs to these farmers. Thus, FCA's oversight increases awareness of the System's mission and prompts associations to provide added resources to serve this market segment. FCA has also recently developed a mission-related performance measure for YBS programs that is based on an evaluation of the effectiveness of every direct lender's YBS program. This measure allows us to evaluate more precisely our success in ensuring that associations maintain adequate YBS lending programs (see page 59).

YBS Loans Outstanding

As of year-end 2001,[3] 16.7 percent of the System's loans outstanding to farmers and ranchers were to borrowers age 35 or under (see Table 4). Borrowers with 10 years or fewer of farming experience accounted for 21.1 percent of loans. Loans to small farmers (those with annual sales under $250,000) accounted for 55.8 percent of loans.[4] The corresponding figures for the total dollar volume of loans outstanding were 12.0, 17.5, and 29.1 percent. Average loan sizes were $62,151 for small farmers, $85,141 for young farmers, and $98,452 for beginning farmers.

3. System data on service to YBS farmers and ranchers are reported as of the end of the calendar year. The 2002 data will be available in April 2003. All YBS loan volume data include loan commitments.
4. YBS data are quoted here for individual young, beginning, or small categories. Since the totals are not mutually exclusive, one cannot add across the young, beginning, and small categories to count total YBS lending. 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 5

Loans Made During 2001 Benefiting Young, Beginning, and Small Farmers and Ranchers[1]

Loan Type	Number of Loans	Percentage of Total Number	Volume of Loans ($ millions[2])	Percentage of Total Volume	Average Loan Size
Young Farmers and Ranchers	31,864	15.3	$3,007	10.2	$94,364
Beginning Farmers and Ranchers	37,017	17.8	$4,187	14.2	$113,112
Small Farmers and Ranchers, by Loan Size					
$50,000 or less	71,508	66.4	$1,428	60.3	$ 19,974
$50,001–$100,000	22,923	53.2	1,649	52.5	71,943
$100,001–$250,000	15,205	41.8	2,291	40.2	150,645
More than $250,000	4,434	21.0	2,241	12.2	505,479
Total Loans to Small	114,070	54.8	$7,609	25.7	$ 66,707

1. A young farmer is defined as 35 years old or younger when the loan is made; a beginning farmer has 10 years or fewer farming or ranch experience; a small farmer is one who typically generates less than $250,000 in annual sales of agricultural or aquatic products. 2001 is the first year of full reporting under new reporting requirements and definitions. Since the totals are not mutually exclusive, one cannot add across young, beginning, and small categories to count total YBS lending.
2. Figures rounded to the nearest thousandth.

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

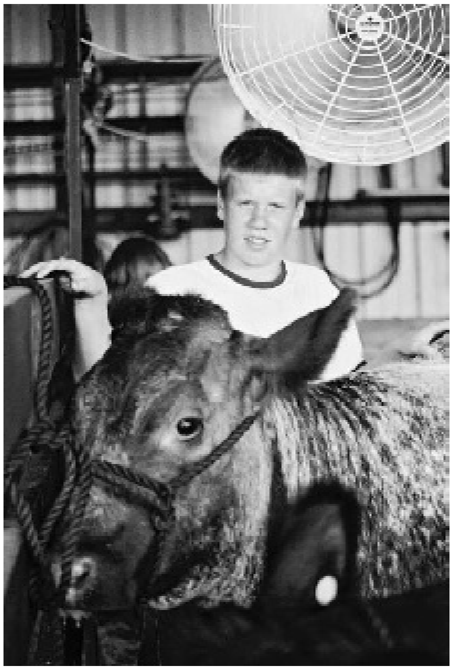
YBS Loans Made

Loans and commitments made during 2001 represent current lending activity and are a good measure of the System's current performance in serving YBS borrowers. For example, FCS institutions made 31,864 loans to young farmers in 2001, which was 15.3 percent of the number of all new loans made to farmers. A total of $3.0 billion in loans were made to young farmers in 2001, 10.2 percent of the dollar volume of loans made during the year. The average size of young farmer loans made during 2001 was $94,364, 34 percent less than the overall average loan size of $143,616 during 2001. (See Table 5 for corresponding percentages and averages for beginning and small farmers.) Increasing capital requirements associated with farming led to a higher average size for loans made during the year, as opposed to those generally older loans that make up loans outstanding at year-end. This relationship was true for all loans as well as for those in the young, beginning, or small categories.

Assessment of YBS Results for Individual Associations and the System

Individual associations vary significantly in their YBS lending results. No single association has the highest percentage in all or even in two of the YBS categories. The wide dispersion of results for loan numbers is shown in Table 6. For example, the number of outstanding loans to beginning farmers range from a low of 6.9 percent of loans in the portfolio to a high of 53.5 percent. For young farmers, the range is considerably smaller, from 2.6 percent to 26.2 percent, while for small farmers the range is much greater, from 3.6 percent to 90.8 percent. In general, we would expect the small farmer and rancher category to have the highest percentages since USDA classifies about 91 percent of all farms as small. YBS lending results for individual associations can now be viewed on FCA's Web site at www.fca.gov.

Regional or institution-to-institution comparisons are difficult to assess because of significant differences in typical-size



Starting From Scratch: A Beginning Farmer in Texas

Cheryl Callis was a single mother, raising two children in an apartment in Texline, Texas, and working three jobs when she saw a for-sale sign for a house with 250 acres of land. "Even though it was run down, I saw some potential. I had a dream to run cattle and horses and wanted to fulfill that dream," says Callis.

With little credit in her own name, Cheryl went to the local U.S. Department of Agriculture Farm Service Agency to seek funding and was referred to First Ag Credit, FCS for help in obtaining a guaranteed loan. "No other lender would touch me in my situation, but First Ag Credit gave me a chance," notes Callis, adding, "First Ag Credit trusted in my ideas and in me when no one else would give me the time of day."

Because of the ongoing drought in Texas, Callis recently started a tree farm as a cash crop, planting 500 trees this fall, with plans for 500 more in the spring. The tree farm was an inexpensive start-up project, and didn't require drilling another well. "I was able to use my existing well and put in drip irrigation. I raise a variety of deciduous trees and have insured them, like any other crop," says Callis.

Callis credits First Ag Credit's commitment to the young, beginning, and small farmer (YBS) program, and notes that it gives younger people an opportunity in agriculture that they can't find anywhere else. "If First Ag Credit had not given me a chance through their YBS program, I would probably still be living in an apartment and maybe working three jobs," Callis says.

farming operations and in farmer demographics. For example, the average investment per farm in California is 80 percent higher than the national average and more than twice that of many states. In addition, the average age of farmers varies considerably from state to state. However, institutions with low YBS percentages are carefully reviewed during the examination process to determine the role of local demographic and economic factors or of management in determining YBS results. Examination follow-up focuses on those cases where improvements by management can play a key role.

Another analytical complication is that year-to-year trends for System YBS lending cannot be made until early 2003. At that time, two years of data (2001 and 2002) will be available under the fully phased-in data reporting and definition requirements, which will enable us to assess year-to-year changes and eventually to look at longer trends in YBS lending.

YBS comparisons of FCS institutions with other lenders cannot be made because other federal regulators do not require reporting on loans to young, beginning, and small farmers. While large banks are required to report on loans to small farmers, a greater maximum size is used to define a small farmer. In addition, because of differences in data definitions and in data collection methods, YBS data are not comparable to Census of Agriculture data.

YBS Programs

Annually, each FCS association responds to the agency's questionnaire on the content of its YBS program. The questionnaire covers areas such as program goals, board reporting, YBS credit provisions, use of government guarantee programs, and provision for training or other related services. At year-end 2001, about 42 percent of FCS institutions had specific YBS goals. This percentage is increasing with the agency's encouragement that all institutions have quantitative YBS goals as a part of their YBS policies.

One question asks about board oversight through periodic reporting. About 88 percent of institutions require YBS borrower loan performance to be reported at least annually to their boards. The agency is encouraging quarterly reporting

Table 6

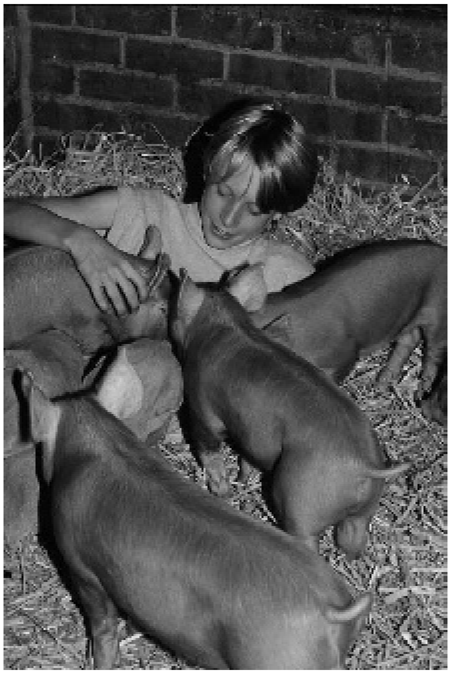
Wide Range in YBS Program Results by Association, 2001[1]

Percentage of Total Loan Number[2]

Program	Loans	Range by Association: Low	Range by Association: High	Overall Average
Young	Outstanding	2.6	26.2	16.7
	Made	3.3	28.1	15.3
Beginning	Outstanding	6.9	53.5	21.1
	Made	4.3	65.1	17.8
Small	Outstanding	3.6	90.8	55.8
	Made	5.7	89.7	54.8

1. A young farmer is defined as 35 years old or younger when the loan is made; a beginning farmer has 10 years or fewer farming or ranch experience; a small farmer is one who typically generates less than $250,000 in annual sales of agricultural or aquatic products. 2001 is the first year of full reporting under new reporting requirements and definitions.
2. The percentages shown are of total loan numbers outstanding as of December 31, 2001, and of total number of loans made in 2001.

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



to highlight the importance of YBS activities at the board level. During 2001, about 25 percent of institution boards required at least quarterly reporting.

YBS programs at many System associations make loan qualification easier by applying differential underwriting standards or by allowing exceptions to underwriting standards. Differential underwriting standards often include higher loan-to-market value ratios or lower debt repayment capacity standards for YBS borrowers. During 2001, about 60 percent of institutions offered differential underwriting standards or exceptions to those standards for YBS borrowers. Also, some associations reduce the farmer's cost through lower rates or fees. Nearly one-half offered lower interest rates and about one-quarter offered lower loan fees for YBS borrowers. For example, one institution waives its requirement that a farmer's income be at least 125 percent of debt repayment requirements and also permits borrowers with limited equity (as low as 20 percent of total assets) to qualify. Another institution offers a "New Generation Loan Program," which provides reduced interest-rate spreads for the first five years and differential underwriting standards to accommodate the financial needs of YBS loan applicants.

USDA's Farm Service Agency is the primary federal agency offering government-guaranteed loans for farmers (see section below), although a small portion of guaranteed loans is made through the Small Business Administration (SBA) and various state programs. System lending institutions made significant use of the FSA's guaranteed lending program. During 2001, FSA guarantees were utilized on nearly 26 percent of the number of YBS loans made, equaling almost 40 percent of new YBS guaranteed loan volume.

Associations offer a wide range of training programs or other services that benefit YBS farmers and ranchers. The most common training program focused on business and financial management skills; about 60 percent offer this service. About 42 percent of associations offer leadership training. Most associations also offer other financial services programs, including estate planning, record keeping, tax planning and preparation, and farm business consulting. Some associations discount or waive the cost of these services for YBS farmers and ranchers.

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.

At the national level, the System operates the Farm Credit System Foundation, Inc. (Foundation). This private organization is a sponsor of organizations that have programs that benefit agriculture's youth and provide development opportunities for those pursuing careers in agriculture. In addition, the Foundation provides scholarships for research on issues important to YBS farmers and ranchers. The Foundation is funded by each of the System's Farm Credit Banks.

Helping Farmers Through Federal and State Loan Guarantees

Use of USDA's guaranteed loan program, operated by the Farm Service Agency, has been increasing among System institutions.[5] 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. A number of states also offer various programs to assist such farmers, including Aggie Bonds with lower interest rates, guarantees, direct loans, and loan participation programs.[6] While FSA guarantees account for the vast majority of funds, the following discussion includes

5. 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.
6. See the Web site: www.stateagfinance.org for more information on programs offered by each state.

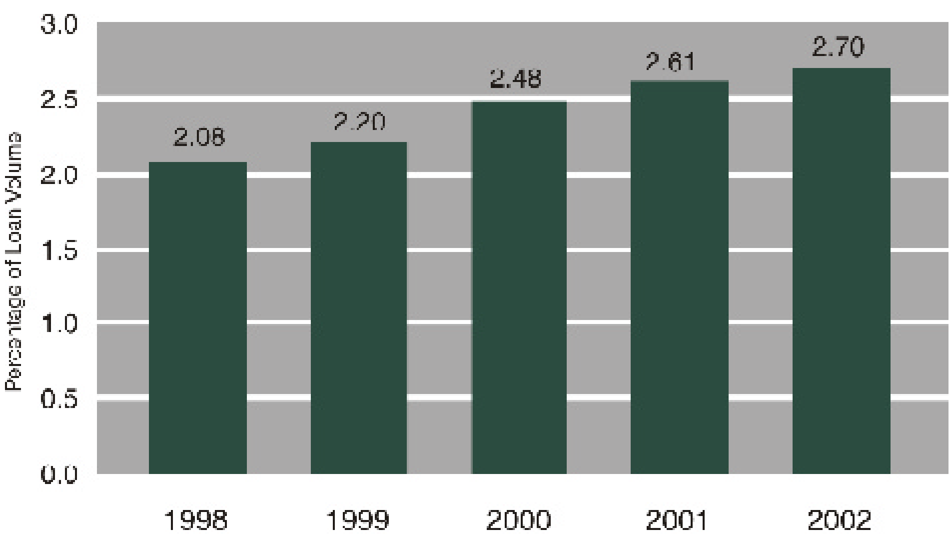
results from state agency farm loan guarantee programs.

Through our examination practices and regulations, we encourage 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 expected 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 status. Further, institutions are not required to maintain as much capital for guaranteed loans (20 percent risk weight versus 100 percent for non-guaranteed loans) when determining their regulatory capital levels.

Although most System institutions take advantage of the FSA and state guarantee programs to help a wide range of borrowers, the largest group of borrowers assisted is the System's young, beginning, and small borrowers. Slightly more than half the System's YBS loans carry FSA or state guarantees.

From September 30, 1998, to September 30, 2002, total loans outstanding to farmers with an FSA or state guarantee changed significantly, rising by $773 million to $1.8 billion, or 75 percent. As illustrated in Figure 6, the System's share of guaranteed loans is growing relative to total loans. As of September 30, 2002, 2.7 percent of the System's loans to farmers were reported as having an FSA or state guarantee, compared with 2.1 percent four years earlier.[7] The System has also been increasing its share of all FSA guaranteed loans, from 15.1 percent three years ago to 21.4 percent as of September 30, 2002. However, the System's share of FSA guarantees is below its overall market share of farm debt.

Figure 6
FCS Increases Use of Guaranteed Farm Loans, 1998–2002
As of September 30



Gross loan volume with a USDA or state agency guarantee as a percentage of total loan volume for all FCS associations.

Source: FCA Loan Account Reporting System.

7. Guaranteed loan totals do not include the small volume of federal guaranteed lending under other programs, nor do they include $2 billion guaranteed by Farmer Mac under its Long-Term Standby Commitment to Purchase program.

More than 95 percent of System institutions participate in the FSA or state guarantee programs. While use at individual associations varies widely, 26 associations had an FSA or state guaranteed volume of more than 6 percent of their total loan volume as of September 30, 2002. However, a nearly equal number had guaranteed loan volume of less than 1 percent of their total loan volume. Tables 7, 8, and 9 show the top 10 associations that participate in the FSA or state guarantee programs ranked in three ways: (1) number of guaranteed loans as a percentage of total number of loans; (2) dollar volume of guaranteed loans as a percentage of total loan volume; and (3) guaranteed loan dollar volume. Altogether 23 associations are ranked in at least one of the tables. The top 10 associations in terms of dollar volume account for 41 percent of the System's FSA- or state-guaranteed loans. Almost all these associations are FSA-preferred lenders.[8]

Institutions that are heavy users of the guaranteed loan programs 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 and state guaranteed loan programs and to develop procedures to participate in them. They also typically have good relationships with FSA and state personnel in their areas. Competition for FSA's guaranteed loan program increased significantly this past fiscal year. This increased competition exhausted available funds, in contrast to recent years when some funding went unused. Despite this competition, more than half the FCS institutions increased their FSA or state-guaranteed volumes by 10 percent or more. Even so, many other associations made little use of guarantees, suggesting that the System has significant potential for expanded use of such programs.

Table 7

Top 10 FCS Associations Ranked by Percentage of Number of Loans with a USDA Farm Service Agency or State Guarantee

As of September 30, 2002

District	Association	Number of Guaranteed Loans	Total Number of Loans	Percentage of Total Number of Loans
Wichita	PCA of Woodward	52	292	17.8
AgriBank	Delta ACA	17	170	10.0
Texas	North Alabama FLCA	204	2,172	9.4
Western	Hawaii ACA	35	380	9.2
AgFirst	Southwest Georgia ACA	212	2,337	9.1
Western	Colusa-Glenn ACA	120	1,448	8.3
CoBank	Maine ACA	71	887	8.0
AgriBank	Northeast Wisconsin FLCA	85	1,083	7.8
Western	Idaho ACA	49	657	7.5
CoBank	Yankee ACA	125	1,889	6.6

Source: FCA Loan Account Reporting System (LARS).

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

Table 8

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

As of September 30, 2002

Dollars in Thousands

District	Association	Guaranteed Loan Volume	Total Loan Volume	Percentage of Total Loan Volume
Texas	North Alabama FLCA	$47,176	$249,719	18.9
Wichita	PCA of Woodward	$4,686	$24,879	18.8
AgriBank	Delta ACA	$3,323	$21,447	15.5
AgFirst	Southwest Georgia ACA	$32,238	$313,825	10.3
CoBank	Maine ACA	$14,260	$146,261	9.7
AgriBank	North Dakota ACA	$31,910	$331,441	9.6
AgFirst	Central Kentucky ACA	$12,064	$128,155	9.4
AgriBank	Western Arkansas ACA	$46,766	$505,324	9.3
AgFirst	Valley ACA	$12,204	$134,685	9.1
AgriBank	Grand Forks ACA	$42,114	$477,497	8.8

Source: Guaranteed loan volume from FCA Loan Account Reporting System (LARS); total loan volume from Call Reports received from the Farm Credit System.

Table 9

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

As of September 30, 2002

Dollars in Thousands

District	Association	Guaranteed Loan Volume	Total Loan Volume	Percentage of Total Loan Volume
AgriBank	GreenStone ACA	$174,258	$2,148,065	8.1
CoBank	First Pioneer ACA	$99,390	$1,562,337	6.4
AgriBank	Missouri ACA	$86,800	$1,181,196	7.3
AgriBank	AgCountry ACA	$69,453	$1,001,217	6.9
AgAmerica	Northwest FCS, ACA	$64,836	$3,986,916	1.6
AgFirst	Carolina ACA	$60,708	$1,021,951	5.9
AgriBank	AgStar ACA	$58,469	$2,081,808	2.8
AgFirst	MidAtlantic ACA	$49,978	$1,234,166	4.0
Texas	North Alabama FLCA	$47,176	$249,719	18.9
AgriBank	Western Arkansas ACA	$46,766	$505,324	9.3

Source: Guaranteed loan volume from FCA Loan Account Reporting System (LARS); total loan volume from Call Reports received from the Farm Credit System.

A Maine Lobsterman Hauls In Quite A Catch

While still a student at the University of Maine, Josh Conover set his sights on his dream—and his future—when he purchased the lobster boat "Satisfaction" and started tending traps. A native of Isleboro, a small island off the central coast of Maine, Josh graduated in 2001 with a degree in resource agribusiness, and quickly began to fulfill another goal: organizing a lobster co-op in his hometown. "During my internship in the Farm Credit Fellows program, I learned about cooperatives," said Conover. "I always wondered why Isleboro didn't take advantage of the quantity of lobster that we have off our coastline, so I worked with my fellow lobstermen and we created one," adds Conover.

While it took some time to plan and organize, a core group of eight experienced lobstermen eventually committed to sign for a $50,000 operating line of credit through Farm Credit of Maine, ACA and a $5,000 start-up capital loan. Conover says that he's lucky his fellow co-op members are good, calming influences, who help him work through the stresses of running a business.

During its first year of operation, the Spruce Island Lobster Co-op handled 120,000 pounds of lobsters and created its own distribution network. "We sell to a dealer in Southwest Harbor, Maine," Conover notes. "Our soft-shelled lobsters are sold to the Canadian market and others are shipped to New York and Boston."

Conover, who is President and Treasurer of the co-op, uses the Internet to market the lobsters, and the Web site, www.Maine-Island-Lobster.com, lets customers purchase live lobsters and explains how to cook them perfectly. "I catch the lobsters. My brother, Zach, runs the Web site from his Oregon home, and my mom, Vicki, ships the product from our island, along with bibs and cooking instructions."

Risk-Based Examination and Supervisory Program

Examinations of FCS institutions must be consistent with agency authorities and statutory requirements. Within those parameters, the amount of examination review and testing that an institution receives depends on the level of institutional risk reflected by the institution's CAMELS-based rating (assigned under FCA's Financial Institution Rating System (FIRS)).

The FIRS rating is the primary risk designation FCA uses internally to indicate the safety and soundness threats in an institution. FCA discloses the composite and component ratings to the institution's board to provide a better sense of where the institution stands relative to the seriousness of examination issues. In addition, each report of examination provides the institution board a detailed assessment of management's performance, the quality of assets, and the financial condition and performance of the institution.

The FCA generally devotes fewer resources to institutions found to be in compliance with statutory and regulatory requirements and operating in a safe and sound manner. The scope and depth of examination testing is based on statutory and regulatory compliance as well as the risk identified, or reasonably anticipated, in the institution. The factors that determine the scope and depth of an examination include: the effectiveness of the institution's internal controls, the examiners' judgment in consideration of the results of previous examinations, the composite and component FIRS ratings, changes that have taken place in the institution since the preceding examination, and guidance provided by field and senior management on areas of risk that should be given special emphasis.

Finally, examiners review the work performed by others, such as internal and external auditors or reviewers. The degree of reliance on this work is based upon the examiners' judgment of the competence and independence of the auditors or reviewers, as well as the scope of the audit or review.

GAO Reports on FCA's Examination and Supervision Program

During FY 2002, the GAO completed a limited review of FCA's current examination and supervision program.[9] In its report, GAO noted:

> [T]he various elements of FCA's safety and soundness oversight and supervision appeared to be timely, comprehensive, and effective. For example, FCA's examinations were timely and covered key areas of risk, such as capital adequacy and internal controls. We observed that FCA required FCS institutions to take appropriate and timely corrective actions to address any identified weaknesses and closely monitored the institutions' compliance. We also found that FCA had special supervisory and enforcement procedures in place and used them when it found more serious weaknesses at FCS institutions. In addition, FCA's off-

9. "Farm Credit Administration: Safety and Soundness Oversight of the Farm Credit System," GAO-02-324R, February 28, 2002.

site monitoring efforts included timely analyses of relevant qualitative and quantitative information that allowed FCA to identify, monitor, evaluate, and proactively address risks faced by FCS institutions. Examples of these efforts include analyses of internal and external audit reports and quarterly stress tests of institutions' loan portfolios. Finally, FCA follows processes designed to ensure the quality and reliability of its safety and soundness examination process through periodic quality assurance reviews and the Inspector General's audits and inspection reports.

While we were encouraged by GAO's findings, we will continue to review and refine our examination and supervision program to ensure its continued relevancy and effectiveness.

Meeting Statutory Examination Requirements

The Farm Credit Act requires FCA to examine each FCS institution at least once every 18 months. However, we maintain the flexibility to complete examination activities at any time, as needed. FCA examines System banks and direct-lender associations with $1 billion or more 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 97 examinations in FY 2002, including examinations of 83 FCS direct-lender associations, six Farm Credit Banks, three 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.[10]

The Small Business Administration and the U.S. Department of Agriculture continued to use FCA's examination expertise in 2002. 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 authorized by USDA to make guaranteed loans under USDA's Business and Industry (B&I) Guaranteed Loan program. Also, FCA examiners completed reviews of B&I program operations at selected USDA State Offices. In addition, FCA staff conducted a training program for USDA staff on program administration, credit analysis, and appraisal review. While the safety and soundness of the System remains the primary objective of FCA, we believe that the continuing use of FCA examination resources by SBA and USDA is a positive reflection on the quality and expertise of FCA examiners and broadens their examination skills while increasing job satisfaction and employee retention.

Measuring the System's Safety and Soundness

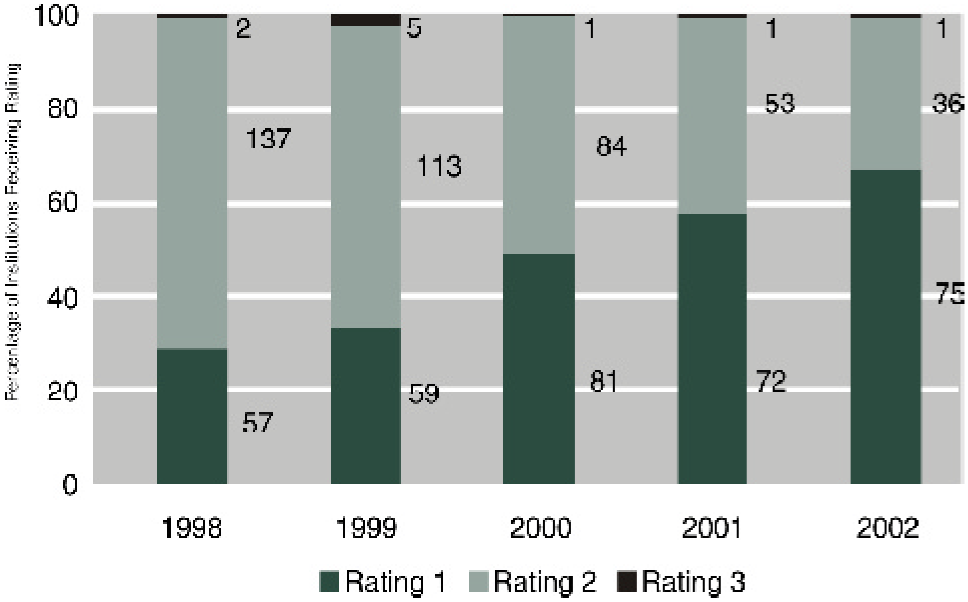
Using the FIRS, examiners evaluate the risk in each bank and direct-lender association at least every 90 days using quantitative and qualitative benchmarks to ensure that assigned ratings reflect current risk and conditions in the FCS. The FIRS provides a general framework for assimilating and evaluating all significant financial, asset quality, and management factors to assign a composite rating to each institution on a scale of 1 to 5. A 1 rating means an institution is sound in

10. The National Consumer Cooperative Bank (NCB) Act of 1978, as amended, provides for FCA 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.

Figure 7

Farm Credit System FIRS Composite Ratings Steadily Improve

As of September 30



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: Farm Credit Administration Examination Reports.

every respect. A rating of 3 means an institution displays a combination of financial, management, or compliance weaknesses ranging from “moderately severe” to “unsatisfactory.” A 5 rating means an institution faces an extremely high, immediate or near-term probability of failure.

Throughout FY 2002, FIRS ratings as a whole continued to reflect the improving financial condition of the Farm Credit System, and, as Figure 7 reflects, the overall trend in FIRS ratings continued to be overwhelmingly positive. At September 30, 2002, the System had more than twice as many 1-rated institutions (75, or 67 percent) as 2-rated institutions (36, or 32 percent). There was one 3-rated institution, which had $257 million in total assets at September 30, 2002.

The strength of FCS institutions displayed by these ratings reflects a financially safe and sound Farm Credit System, thanks in part to government support program payments, which allow many borrowers to meet debt obligations during a period of low market prices for many 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.

Identifying Potential Threats to Safety and Soundness

Every six months, the FCA uses a financial forecasting model to identify and evaluate prospective risk in institutions over the next 12 and 24 months under “most likely” and “worst case” scenarios, respectively. By evaluating each institution’s financial condition and performance under each scenario, we can identify institutions with emerging risks. This evaluation helps FCA carry out the risk-based supervision program to ensure that FCS institutions address and correct problems before irreparable harm to their financial conditions occurs. Our current

financial forecasting analysis, based on June 30, 2002, Call Report data, projects that the financial condition of the FCS will remain sound through June 30, 2003, and June 30, 2004, under "most likely" and "worst case" scenarios, respectively. These projections rely heavily on the expectation of continued government support for agriculture.

FCA's early warning system includes a loan portfolio stress model to evaluate the potential impact of interest rate changes and a decline in borrower repayment capacity on an institution's earnings and financial condition. In addition, we perform an analysis of new money, refinancing, and rollover trends to identify the potential for transfer of risk from other lenders to FCS institutions (especially during stressful times in agriculture). We also maintain a database of FCS institutions' underwriting standards to analyze whether boards are properly adjusting standards in response to changing risk. During FY 2002, the results of these analyses indicated the System would remain financially sound and well-positioned to meet its public mission through good and bad times.

Differential Supervision and Enforcement

Some risks are inherent to lending, and lending to a single industry such as agriculture is particularly risky. If our examiners discover unwarranted risks, they work with the institution's management and board to establish a plan of action to mitigate or eliminate such risks. Appropriate actions may include reducing exposures, increasing capital, or strengthening risk management.

When an individual 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. The board then must provide FCA with a written response that addresses how the problems will be corrected, including specific time frames for correction. Thirty-nine percent of FY 2002 reports contained required actions. For the three years prior to FY 2002, the trend in required actions was generally favorable, reflecting the improving risk-bearing capacity of the System during that time period.[11] However, the percentage of reports that contained required corrective actions increased in FY 2002 over that reported in FY 2001. This increase was attributed to a higher number of regulatory violations identified by examiners, particularly in institutions experiencing rapid loan growth.

FCA uses 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 that 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 correc-

11. Twenty-eight percent of the reports issued during FY 2001, 38 percent of the reports issued during FY 2000, and 66 percent of the reports issued during FY 1999.

tive actions. In addition, we regularly recommend to institution boards ways to improve the efficiency or effectiveness of their risk management processes and/or controls to maintain financial stability. This practice of requiring corrective actions and recommending improvements to processes and/or controls is critical to our success in supervising regulatory compliance and the safety and soundness of FCS institutions.

For institutions displaying conditions that are serious but do not necessarily critically impair their safety and soundness, 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. This process has been successful where 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.

A formal enforcement action may be necessary if an institution engages in unsafe or unsound practices, violates laws or regulations, or exhibits excessive risk, and its board and management are unable or unwilling to correct the problems. FCA uses its enforcement authority to ensure that the operations of FCS institutions are safe and sound, do not exhibit excessive risk, and comply with laws and regulations. This authority includes the power to enter into 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, these institutions perform under enforcement supervision and our examiners oversee the institution's performance to ensure compliance with the enforcement action.

Working with Financially Stressed Borrowers

Agriculture is a risky business that can be affected by adverse weather, changes in imports and exports, and local supply and demand, sometimes causing borrowers difficulty in repaying their loans. The Farm Credit Act provides borrowers with certain rights when they apply for loans and when they have difficulty repaying loans. For example, the Act requires FCS institutions to consider restructuring an agricultural loan before initiating foreclosure. The Act also provides an opportunity for borrowers to seek review of certain credit and restructuring decisions. If a loan is foreclosed, the Act provides borrowers with the opportunity to buy back their property at the fair market value.

FCA adopted regulations to implement the borrower rights provisions of the Act. FCA also includes a review of borrower rights compliance in its examination of FCS institutions. Further, FCA receives and reviews complaints from borrowers regarding their borrower rights. Through these efforts, FCA helps the FCS institutions ensure that every effort is made to retain loans with improved prospects for repayment and, at the same time, continue to provide sound and constructive credit and related services to farmers and all types of agricultural producers.

Challenges Facing Agriculture and the Rural Economy

The FCA actively monitors and evaluates systemic risks to the Farm Credit System. These systemic risks cover agricultural, financial, and economic developments that both directly and indirectly affect System institutions and their borrowers. While we do not attempt to forecast specific events, we evaluate various risks, before they materialize, that might pose serious threats to one or more institutions. The following are the principal risks we have identified, those that pose the most significant threats to the financial performance of the System and its institutions.

Mixed Prospects for U.S. Economy

A series of interest rate reductions by the Federal Reserve, along with tax cuts, helped spur an economic recovery from the recession that began in March 2001. Many areas of the country reported strong consumer loan demand in 2002, particularly for home refinancing, but weak commercial lending activity due to the uncertain economic environment. While residential real estate has been a bright spot in the economy, weaker performance is expected for the fourth quarter of 2002 because of sluggish economic growth and weak labor markets. Credit quality is slipping, particularly in commercial and industrial loans at large commercial banks (assets over $1 billion). Interest rates on farm-related loans have trended down, providing relief to farmers who refinanced or had variable-rate loans. The Federal Reserve took an aggressive step on November 6, 2002, to boost the sluggish U.S. economy by cutting the target federal funds rate 50 basis points to 1.25 percent, a 45-year low. Borrowers may have seen their last interest rate cut if the economy begins to pick up speed in the first quarter of 2003.

Gross domestic product grew about 3 percent for the 12-month period ended September 30, 2002, which is adequate for a growing economy but low for an economy rebounding from a recession. Fourth-quarter growth is expected to be well below 3 percent, reflecting weakening consumer and investor confidence, corporate accounting scandals, a volatile stock market, weak labor markets, and prospects for further military conflicts.

U.S. farm households today depend on off-farm income sources for more than 90 percent of their total income. More than half of farm operators and their spouses are employed off their farms. Thus, the health of the general economy is critical to the vitality of rural America, which includes customers of the Farm Credit System. If the recovery of the general economy remains weak into 2003, higher unemployment rates, lower wage and salary incomes, and reduced investment income could lead to deteriorating loan portfolios at System institutions.

Farm Real Estate Robust but Uncertainty Lies Ahead

Despite the sluggishness of the general economy, the farm real estate market continued to show strength in 2002. Good quality farmland in the Chicago Federal Reserve District was up nearly 6 percent in mid-2002 from a year ago, and other regions of the country enjoyed similar strength. With interest rates at 45-year lows, single-family housing markets continued to show strength in both numbers sold and price, though some softening had occurred midway through the fourth quarter of 2002. New housing is creating upward demand pressure for rural real estate as housing tracts move beyond the urban fringe. Furthermore,

the government payments associated with the Federal Agricultural Improvement and Reform Act of 1996 (1996 Farm Act) have sustained farm income during a period of low commodity prices that began in 1997, which has underpinned the financial balance sheet of the farm sector.

The passage of the Farm Security and Rural Investment Act in May 2002 (2002 Farm Act) reaffirmed the continuation of strong government support for the next six years. Payments are expected to lead to further gains in rural real estate values and rents, which is favorable for landowners, but an increasing challenge for beginning farmers.

An opposite concern is over-inflated housing prices and the weakening of this market should the economic recovery stall. In some regions, such a development could affect rural real estate markets, causing some weakening in land values and undermining collateral positions of borrowers.

Farm Income Drops in 2002 with Possible Recovery in 2003

The agricultural sector was battered in 2002 by widespread drought and, in the South and on the East Coast, by tropical storms and hurricanes. Net farm income for 2002 is forecast at $36.2 billion, a $9.6 billion decline, nearly 21 percent, from farm income in 2001; this would be its lowest level since 1986. The forecasted decline resulted from a drop in both cash receipts and government payments. Farm cash receipts are forecast to decline 3 percent as a drop in livestock receipts offset an increase in crop receipts, reflecting the drought-induced higher prices for major program crops. However, higher prices were of little consolation for many farmers in the AgAmerica, AgFirst, and Wichita Farm Credit districts, where production was down sharply.

Livestock receipts fell in 2002 due to lower prices as farmers accelerated their herd liquidation in response to higher feed costs and poor quality pasture. Although System lenders with high loan concentrations in livestock, particularly hogs and dairy, were exposed to down-side price risk, USDA provided some emergency relief in the form of direct payments to producers of grazing livestock in the fourth quarter of 2002, which relieved some of the financial stress. In addition, insured growers received some $4 billion in crop insurance payments in the fourth quarter.

Farm income could recover somewhat in 2003 if prices for most crop and livestock products increase as expected. However, returns for some commodities, especially rice and cotton, and to a lesser extent hogs, milk, and soybeans, are expected to remain below the average levels of the 1990s due to continued large supplies relative to demand. These conditions could lead to some financial stress in these sectors. Production of major fruit crops, particularly apples and pears, declined from a year ago, which will likely result in continued stronger grower prices for the 2002–2003 marketing year. A smaller Florida citrus crop is expected to boost grower prices as well. The raisin industry continues to struggle with oversupply, lower prices, and increased cultivation costs. The improved overall farm income outlook for 2003 is also dependent on an improved international trade picture, which will depend on general economic conditions and new trade policies.

Adding Value to A Commodity: The Crave Family Farm

The Wisconsin-based Crave family, owner of the dairy business that bears their name, has seen many changes since their operation began nearly a quarter of a century ago. But one thing has not changed—their relationship with Badgerland Farm Credit Services, ACA. "We've been customers since the inception of our business," says Charles Crave, one of the four brothers who share the hard work of running the company.

Crave Brothers Farm has 640 head of milking Holsteins, with annual production averaging 30,000 pounds per cow. The family raises their own replacement stock and farms 1,300 acres of corn, alfalfa, soybeans and barley. Recently the family opened an on-farm cheese processing facility, the first of its kind in Wisconsin, to produce fresh mozzarella and mascarpone under the label Crave Brothers Farmstead Classics. Debbie Crave, Charles' sister-in-law, who worked in the cheese business for 20 years, is heading up the marketing arm of the company.

Badgerland provides mortgage and operating loans, as well as crop insurance, recordkeeping, and tax planning, and it has helped them as they expanded into the value-added segment of their business. "We've had excellent cooperation from our loan officer and FCS management as we've proceeded into the cheese business," notes Charles Crave. "Farm Credit has provided us with good financial tools, allowing us to see how our management practices have worked through the years."

New Farm Act Ensures High Level of Government Payments

The passage of the 2002 Farm Act effectively ends the debate about the future of government support to agriculture for the next few years. The 2002 Farm Act represents a departure from the 1996 Farm Act, which sought to reduce government subsidies and transition farmers to a more market-oriented approach to farming. The 2002 Farm Act provides a generous farm safety net to traditional program commodities (grains, cotton, peanuts, sugar, and dairy) and adds some new ones (oilseeds, pulses, apples, and onions) through a variety of payment programs (direct, counter-cyclical, deficiency, market assistance), which ensures a high level of government support to agriculture for years to come.

The 2002 Farm Act contains some familiar features plus some new ones. The direct payment program replaces the production flexibility contract payments program in the 1996 Farm Act. A counter-cyclical program was added in the 2002 Farm Act to compensate farmers when commodity prices are low and to reduce the need for emergency assistance. Loan rates for most commodities are raised under the 2002 Farm Act, which will increase subsidy payments when prices fall and could deplete appropriated funds if prices fall sharply for most program crops. The 2002 Farm Act also increases funding for conservation, food safety, animal/plant disease protection, and rural development. It also improves guaranteed loan program benefits under the Farm Service Agency, thereby increasing support to limited resource farmers. Improved eligibility and a more streamlined application process make it a more attractive program for agricultural lenders.

Despite the prospects for higher government payments in future years, strengthening crop prices, the transition to a new set of payment instruments, and delays in Congress over emergency relief worked together to lower government farm payments in 2002. USDA estimates direct government payments to farmers for 2002 at $17 billion, representing a drop of $3.8 billion or 18 percent from 2001. Sharply lower outlays for emergency assistance and loan deficiency payments more than offset the outlays under the new set of payment variables during 2002. A major part of this drop is a one-time transition to the 2002 Farm Act as the instruments that basically replace the emergency assistance are spread out over the marketing year, rather than being paid in the final quarter.

The 2002 Farm Act does not buffer all producers from all risks. While it offers price protection, it does not guard against yield reductions. In addition, rising crop prices reduce counter-cyclical payments to all producers. Most lenders strongly encourage or require the use of available crop insurance programs, which are subsidized by the government. Overall, commodity programs represent only about 40 percent of the System's loan portfolio. The livestock sector (except dairy) and fruits, vegetables, and nursery products continue to be the most significant sectors not covered by commodity programs.

Government payments have become an increasingly important source of income to farm households since 1997. Government payments as a share of net farm income are estimated at nearly 47 percent for 2002, similar to levels of the past three years but more than triple the level of 1997. The return of federal budget deficits and criticism by the international community over the high level of government support prescribed in the 2002 Farm Act could make future deliberations over government outlays more contentious. The continued dependence of the agricultural sector on government outlays for a large share of its income could pose problems for lenders in the future should payments decline at a time of depressed prices.

International Trade Challenges Lie Ahead

Farmers continue to depend on foreign markets as agricultural productivity continues to outpace the domestic demand for food. Agricultural exports are estimated at $53.3 billion in fiscal year 2002, comprising about 8 percent of total U.S. foreign trade. Agricultural exports for fiscal year 2003 are forecast to rise to $57.0 billion, a 7 percent increase over fiscal year 2002 and just 5 percent below the peak in 1996. Trade has been critical to the vitality of the U.S. agricultural economy for decades. Today, export revenues account for more than one-quarter of farm cash receipts and more than one-fifth of U.S. agricultural production. Agriculture's trade exposure is substantially higher for certain commodities, which are all financed by the System: 61 percent of U.S. cotton, 59 percent of wheat, 47 percent of rice, 33 percent of soybeans, and 21 percent of corn production are exported. The trade exposure for livestock is smaller but significant—broilers 16 percent, beef 9 percent, and pork 8 percent. Thus, political, economic, social, and environmental developments outside of U.S. borders are critical to the financial viability of these producers.

The United States continues to face a number of challenges in moving farm products into international markets, including: large supplies from other exporters (notably Brazil and Argentina), consumer resistance to biotech products, import barriers, the high value of the dollar relative to other currencies, and, more recently, a slowdown in global economic activity, which could reduce the demand for farm products. As a result, the United States has seen its share of world trade in certain key commodities diminish from peak levels achieved in the 1960s and 1970s. In the case of soybeans, the U.S. share of world trade has declined from more than 90 percent in the 1960s to just 40 percent today; for wheat, the U.S. share has shrunk from an average of 39 percent during the 1970s to about one-quarter of the market today. Eliminating import barriers and export subsidies in international agricultural trade is paramount for the continued health of the U.S. agricultural sector and the Farm Credit System.

Security Concerns Affect Bottom Line

The world has changed significantly since September 11, 2001. The terrorist attacks on the United States have created fear, reduced travel, and heightened security demands, which have all affected the economy, both directly and indirectly, and will continue to do so in the future. The cost of doing business, including the production and processing of food, has increased because of higher costs of providing security, back-up systems, and insurance. The food and agricultural sectors need to guard against deliberate contamination of the nation's food supply as it moves from the farm through processing to the retail outlets. In addition to installing more advanced security systems, farmers and other handlers of crops, livestock, and processed food products will require additional training, not only to safeguard the food system, but also to respond to attack. The threats posed by terrorists underscore the importance of establishing and maintaining secure production, processing, storage, and transportation systems, as well as diversified and decentralized economic and financial institutions.

Corporate Activity, Regulatory Guidance, and Other Agency Activities

FCS Structure Continues Its Evolution

In FY 2002, the Farm Credit System's structure continued to consolidate, reflecting a general trend throughout the financial services industry. System institutions are moving toward a single type of direct lender association—an Agricultural Credit Association (ACA) with wholly owned Production Credit Association (PCA) and Federal Land Credit Association (FLCA) subsidiaries (see glossary for definitions). The ACA parent/subsidiary structure is now the most common structure in the System and accounted for 78 percent of all associations on September 30, 2002.[1] Under this structure, the ACA and its subsidiaries operate with a common board of directors and joint employees and are obligated on each other's debts and liabilities. The structure also allows the ACA to build capital more efficiently. Additionally, the structure enables customers to be 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 results in the efficient delivery of credit and services to member-borrowers. This section describes the changes in the FCS structure that occurred during FY 2002.

Of 84 ACAs, three have not yet adopted the ACA parent/subsidiary structure. In addition, 20 single title associations (including four PCAs, which are authorized to provide short- and intermediate-term credit, and 16 FLCAs, which are authorized to provide long-term credit) continue as independent associations. However, based on applications pending as of September 30, 2002, all four PCAs and three of the 16 FLCAs are expected to transition to the new structure by January 1, 2003. Also, one of the three remaining stand-alone ACAs is expected to restructure on January 1, 2003.

Summary of Activity

The number of corporate applications submitted for agency approval decreased significantly during the year. In FY 2002, we analyzed and approved 24 applications, compared with 69 applications processed during 2001. The applications processed were:

- six consolidations of unlike associations to form ACAs, which also established a PCA and an FLCA as wholly owned subsidiaries of the ACA,
- six restructurings of ACAs to establish a PCA and an FLCA as wholly owned subsidiaries of the ACA,
- three charter conversions of PCAs and FLCAs to ACAs with subsidiaries (these associations converted to the ACA form without having a merger partner),
- one consolidation of ACAs with subsidiaries,
- one merger of ACAs with subsidiaries,
- one merger of a PCA into an ACA with subsidiaries,
- one merger of a PCA and an FLCA into an ACA with subsidiaries,
- one consolidation of a PCA, FLCA, and ACA to establish an ACA with four subsidiaries,
- one bank name change,
- two association headquarters' moves, and
- one association name change.

The total number of associations decreased by 12 percent from 118 on September 30, 2001, to 104 on September

1. FCA, in approving the ACA parent/subsidiary structure, views the ACA and its wholly owned operating subsidiaries as a single entity for most 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.

30, 2002. However, the number of ACAs increased from 78 to 84 during the same period, and the number of ACAs with subsidiaries increased from 69 to 81. Figure 8 depicts the chartered territory of each FCS bank. More details about specific corporate applications in FY 2002 can be found on FCA's Web site at www.fca.gov.

Bank Activity Involving AgAmerica, FCB, AgriBank, FCB, and CoBank, ACB

Two significant restructurings were underway at the close of FY 2002 that involved three banks and two of the largest associations in the System. On December 31, 2001, the Western Farm Credit Bank and AgAmerica, FCB (AgAmerica) terminated their joint management agreement, which had been in place since March 1, 1997. On January 1, 2002, AgAmerica entered into a new joint management agreement with AgriBank, FCB (AgriBank) with the intent of pursuing a merger with AgriBank. However, one of AgAmerica's stockholders, Northwest Farm Credit Services, an Agricultural Credit Association (Northwest ACA), favored affiliation with CoBank, ACB (CoBank), which operates under both title I and title III of the Act.[2]

After considering its options, the AgAmerica board of directors recommended a merger with AgriBank. However, the AgAmerica board concluded that Northwest ACA should determine the affiliation best suited for its member-borrowers. Accordingly, the AgAmerica board established a plan to facilitate Northwest ACA's reaffiliation with CoBank prior with AgAmerica's merger into AgriBank.

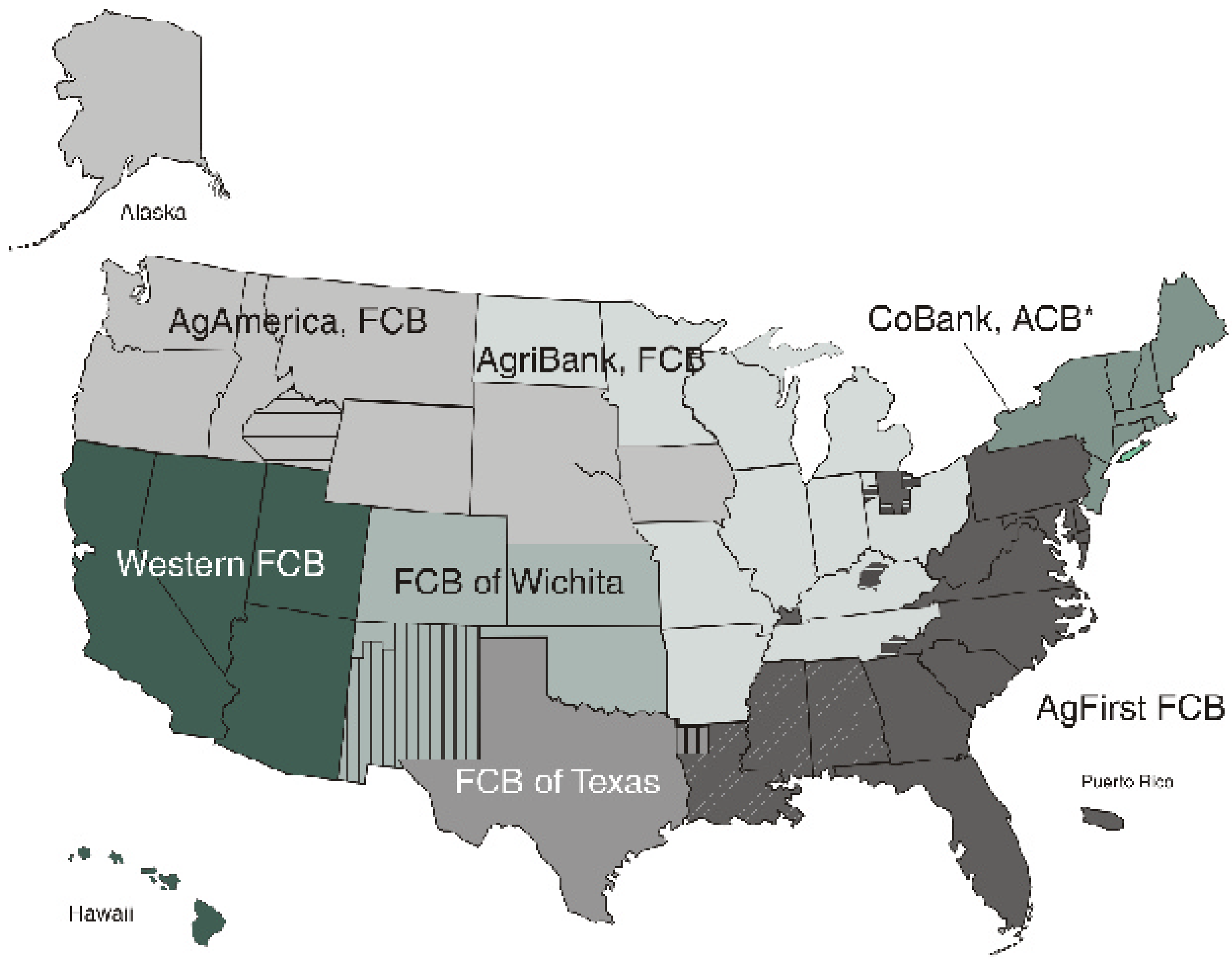
At the end of FY 2002, FCA staff was reviewing the applications for the reaffiliation of Northwest ACA with CoBank and AgAmerica's merger into AgriBank. If the FCA Board approves them,[3] the proposals will be subject to approval by the voting stockholders of the banks involved. The voting stockholders of CoBank and AgAmerica will vote on the reaffiliation of Northwest ACA, and voting stockholders of AgAmerica and AgriBank will vote on the bank merger. If approved, the reaffiliation and the merger would occur on January 1, 2003. The territory that Northwest ACA serves—the states of Alaska, Idaho, Montana, Oregon, and Washington, and parts of northern California and western North Dakota—would be included in CoBank's title I charter authorities on January 1, 2003. The remaining territory of AgAmerica—the states of Iowa, Nebraska, South Dakota, and Wyoming, which Farm Credit Services of America, ACA serves—would be added to AgriBank's charter on the same date. AgriBank's headquarters would remain in St. Paul, Minnesota.

Bank Activity Involving the Western Farm Credit Bank and the Farm Credit Bank of Wichita

The Farm Credit Bank of Wichita (FCBW) and the Western Farm Credit Bank (WFCB) became jointly managed on January 1, 2002. Their respective boards of directors have agreed to pursue a merger, with an effective date of October 1, 2003, if approved by the FCA Board and the voting stockholders. In a related action, on August 2, 2002, the FCA Board approved a change in name for the FCBW to U.S. AgBank, FCB, effective October 1, 2003. Although the FCBW and WFCB maintain separate corporate headquarters in Wichita, Kansas, and Sacramento,

2. Under Title I, CoBank can provide services and funds to local associations in New England, New York, and New Jersey that, in turn, lend those funds to farmers, ranchers, producers, and harvesters of aquatic products, rural residents for housing, and some agriculture-related businesses. Under Title III, CoBank can lend to and provide other financial services to farmer-owned cooperatives, rural utilities (electric and telephone), and rural sewer and water systems within the United States including Puerto Rico. It is also authorized to finance U.S. agricultural exports and provide international banking services for farmer-owned cooperatives.
3. The FCA Board granted preliminary approval of the applications on October 10, 2002. The FCA granted final approval on December 31, 2002. The reaffiliation and merger were effective on January 1, 2003.

Figure 8
Farm Credit System Banks Chartered Territories
As of September 30, 2002



AgAmerica, FCB	Western FCB	FCB of Wichita	FCB of Texas	AgriBank, FCB	CoBank ACB	AgFirst FCB
2 ACA Parents♦	12 ACA Parents♦ 1 FLCA	13 ACA Parents♦ 4 FLCAs 3 PCAs	12 ACA Parents♦ 10 FLCAs	17 ACA Parents♦ 1 FLCA 1 PCA	4 ACA Parents♦	21 ACA Parents♦ 3 ACAs

Ag New Mexico, Farm Credit Services, ACA is 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. First South Farm Credit, ACA is funded by AgFirst FCB.

Louisiana Ag Credit, ACA is funded by the FCB of Texas.

*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.

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

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

Idaho ACA is funded by the Western FCB.

California, respectively, Wichita serves as the location for the banks' combined operations under joint management.

1998–2002: A Period of Rapid Change and Improved Performance for the System

The changes taking place during 2002 (as described above) are part of a five-year trend, beginning in 1998, whereby the structure of the Farm Credit System underwent dramatic change with strong performance. Two developments contributed significantly to this trend: the FCA Board's approval of a new ACA parent/subsidiary structure in July 1999 and an Internal Revenue Service ruling in September 1999 that the FLCA subsidiary in the ACA parent/subsidiary structure was tax-exempt. In response to these developments, boards of directors at FCS associations increasingly adopted the new ACA corporate structure while other institutions merged to create larger more geographically diverse, and better-capitalized financial organizations. These changes occurred during a period of increased globalization of both financial and agricultural markets, rapid advances in communications technologies, greater deregulation of financial institutions, and demographic changes leading to a variety of new customer demands.

Strong financial performance for System institutions during 1998–2002 resulted in healthy loan growth, favorable earnings, and a high level of credit quality. These achievements are attributed to a combination of factors including new loan products and services, cost-containment programs, improved risk management practices, and scale economies stemming from mergers, restructurings, and joint management arrangements among System institutions. Contributing external factors include a healthy economy through the majority of the period and large government payments to the agriculture sector in response to depressed commodity prices.

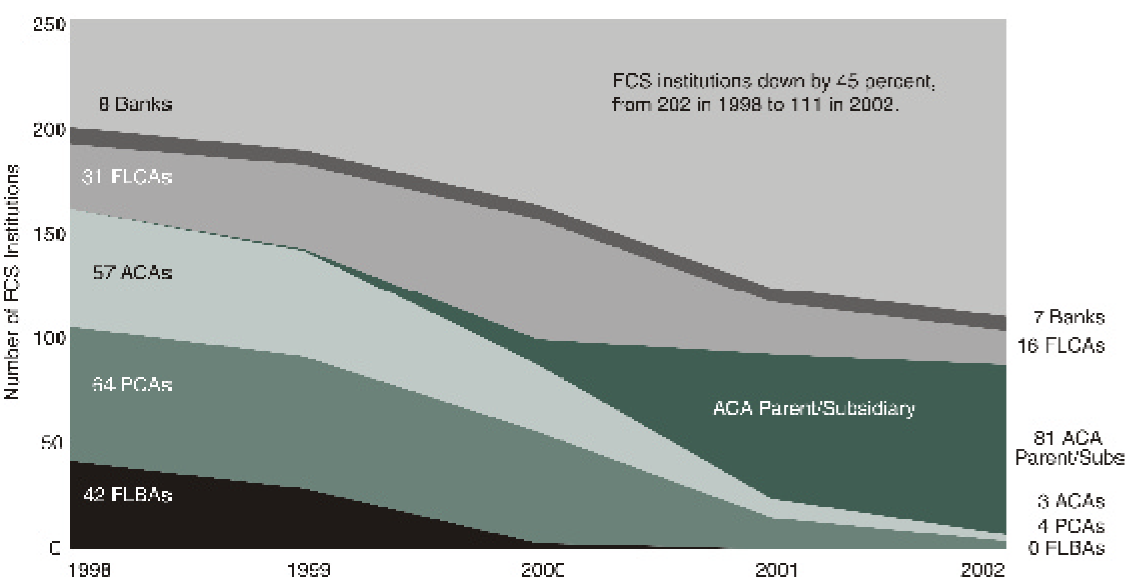
System Institutions Decrease in Number and Grow in Size

Between September 30, 1998, and September 30, 2002, the number of System

Figure 9

Trend in Numbers of Farm Credit System Banks and Associations

As of September 30



Source: FCA, Office of Policy and Analysis, Risk Analysis Division.

institutions continued its long-term decline as a result of mergers among existing institutions and restructurings into the ACA parent/subsidiary structure. The total number of System banks and associations declined from 202 to 111 during this period, a drop of 91 institutions or 45 percent (see Figure 9). The number of banks declined from eight to seven with the July 1, 1999, merger of the St. Paul Bank for Cooperatives with CoBank, ACB. By October 1, 2000, all FLBAs either converted to FLCAs or merged with PCAs to become ACAs. The total number of direct lender associations (ACAs, FLCAs, and PCAs) declined by 32 percent from 152 to 104, with the ACA parent/subsidiary becoming the predominant association structure.

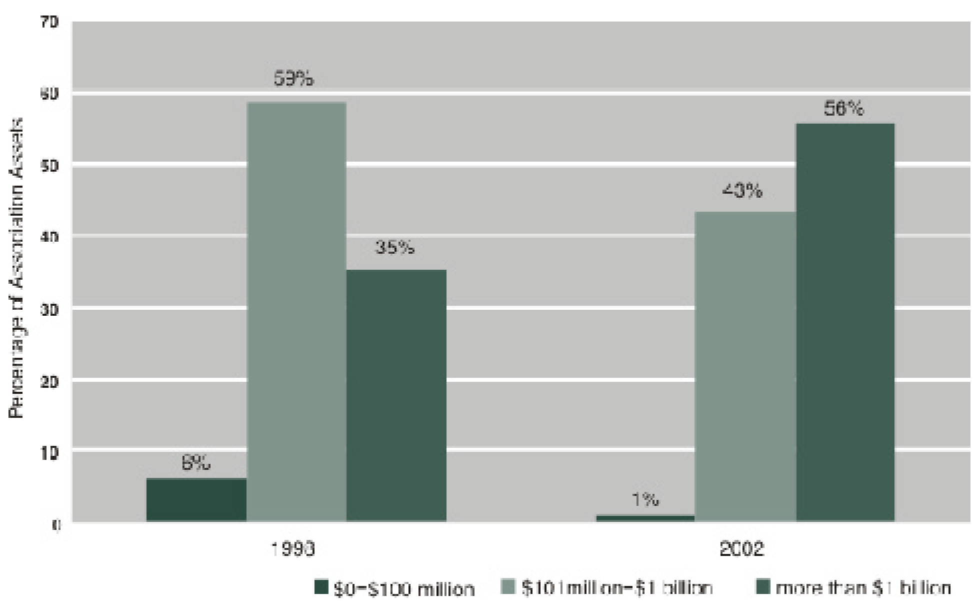
With the decline in institution numbers, the average asset size of System institutions has increased sharply. System banks rose from $9.3 billion in average assets as of September 30, 1998, to $13.6 billion as of September 30, 2002, a 46 percent increase. During this same period, the size of the smallest bank grew 164 percent to $5.9 billion, while the size of the largest bank grew by one-third to nearly $26 billion. To provide some comparison with commercial banks, CoBank, the System's largest institution, is only about as large as the 33rd largest commercial bank.

The growth in System association asset size during the 1998–2002 period was even more dramatic than that for banks. The average size of direct-lender associations increased 132 percent between 1998 and 2002 to $652 million. The largest institution increased 44 percent to $7.0 billion, and the smallest institution increased 74 percent to $23 million. Furthermore, the number of associations with more than $1 billion in assets rose markedly between 1998 and 2002, coinciding with the overall growth in System assets and merger activity. As of September 30, 1998, only six associations, or 4 percent of the total, had assets in excess of $1 billion; on September 30, 2002, the number of such associations had increased to 16 or about 15 percent of the total. With the increasing number of larger associations came an increase in the

Figure 10

Increasing Percentage of FCS Association Assets now Reside in the Largest Institutions

As of September 30



Source: Call Reports received from the Farm Credit System.

concentration of System assets. As of September 30, 1998, 35 percent of total association assets were held by institutions with assets of more than $1 billion; by September 30, 2002, this number had increased to 56 percent (see Figure 10).

System Banks and Associations Generally Have Become More Efficient

One rationale for associations to merge or restructure, in recent years, was to lower operating costs by employing personnel and equipment more efficiently and eliminating duplicate activities. Annual operating expenses as a percentage of total loans (operating expense rates) for banks declined 0.11 percentage points on average between September 30, 1998, and September 30, 2002, to 0.35 percent, although two of the seven banks posted expense increases. Operating expense rates for associations declined 0.22 percentage points on average to 1.45 percent. All districts showed improved operating efficiencies between 1998 and 2002. More than 70 percent of the associations had operating expense rates of less than 2 percent in 2002, compared with 58 percent of the associations in 1998. FLCAs on average had the largest operating expense rates decline (from 1.30 percent to 1.09 percent), followed by ACAs (from 1.60 percent to 1.46 percent). However, operating expense rates for the four PCAs that were still active on September 30, 2002, were higher on average (2.99 percent) than the 64 that were operating on September 30, 1998 (2.36 percent).

Regulations

FCA issues regulations and policy statements to ensure that the Farm Credit System complies with the law, operates in a safe and sound manner, and efficiently carries out its statutory mission. We also issue Bookletters, which clarify agency positions on various issues and provide guidance to the FCS. The following describes some of our efforts during FY 2002.

Young, Beginning, and Small Farmers and Ranchers

We published an Advanced Notice of Proposed Rulemaking (ANPRM) soliciting comments to help us decide what changes we should make to our policies and programs regarding young, beginning, and small farmers and ranchers. We sought comments on ways to (1) develop clear, meaningful, and results-oriented guidelines for System YBS policies and programs, (2) measure the System's YBS performance to ensure that the System is fulfilling its YBS statutory mission, and (3) provide adequate reporting and disclosure to the public on the System's compliance with its statutory YBS mission. (Adopted September 12, 2002; published September 23, 2002 [67 FR 59479]; comment period ended December 23, 2002)

Capital Amendments

We proposed a rule that would amend portions of our capital adequacy regulations. The proposed rule would add a definition of total liabilities for the net collateral ratio calculation and would limit the amount of term preferred stock that may count as total surplus. Two System banks petitioned us to limit the impact of new accounting requirements for derivatives when calculating their net collateral ratios. We responded to the banks' petition by adding a definition of total liabilities to exclude derivatives that are used by banks to hedge against interest rate risk. We believe such hedges should not negatively affect a bank's net collateral ratio because these instruments protect a bank against declines in net collateral. However, derivatives that are not used as hedges are included in our proposed definition of total liabilities. We also proposed limiting the amount of preferred stock that a System institution can count as total surplus. We believe System institutions should not overly rely on term preferred stock to meet regulatory capital requirements. (Adopted September 12, 2002; published October 22, 2002 [67 FR 64833]; comment period ended November 21, 2002)

Electronic Commerce

We issued a final rule reflecting emerging business approaches to electronic commerce (e-commerce). The rule is 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. We created new regulations on e-commerce and amended regulations to allow electronic disclosures to shareholders. We undertook the rules because System institutions asked for guidance on e-commerce and because of the enactment of the Electronic Signatures in Global and National Commerce Act. We believe that the rule will result in cost savings for FCS institutions and their customers who chose to use e-commerce. (Adopted March 21, 2002; published April 8, 2002 [67 FR 16627]; effective May 8, 2002)

Termination of Farm Credit Status

We issued a final rule to allow an FCS institution to terminate its FCS charter and become a financial institution under another federal or state chartering authority. The rule applies to all FCS banks and associations. In addition, the rule ensures 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. The rule meets a statutory requirement and benefits any System institution that desires a change in structure, while ensuring that the exit fee required by law is paid to the Farm Credit Insurance Fund. (Adopted March 21, 2002; published April 12, 2002 [67 FR 17907]; effective May 13, 2002)

Loan Purchases and Sales

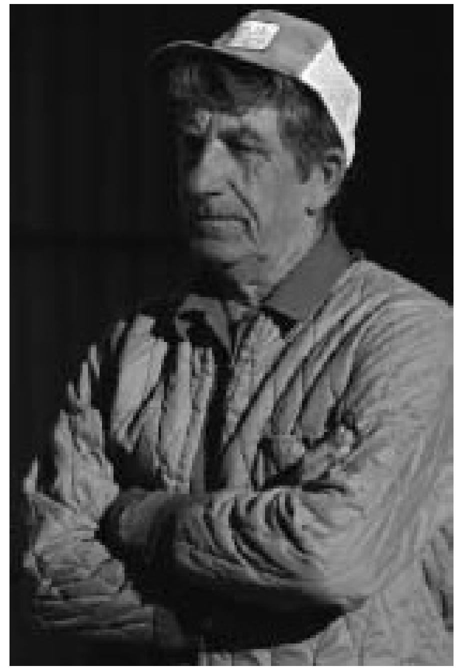
We issued a final rule to enable FCS institutions to better use existing statutory authority for loan participations by eliminating unnecessary regulatory restrictions that may have impeded effective participation relationships between System institutions and non-System lenders. System institutions now have greater flexibility to buy loan participations from non-System lenders under certain conditions. (Adopted December 13, 2001; published January 10, 2002 [67 FR 1281]; effective March 4, 2002)

National Charters

In FY 2001, we proposed a regulation to allow FCS direct-lender associations to obtain national charters so that they would be less restricted by geographical boundaries in serving farmers, ranchers, and aquatic producers and harvesters. (Adopted January 11, 2001; published February 16, 2001 [66 FR 10639]) We subsequently extended the comment period for the proposed rule to April 20, 2001. (Adopted March 16, 2001; published March 21, 2001 [66 FR 15814]) Early in FY 2002 (October 11, 2001), staff presented a draft final rule to the FCA Board. At the meeting, the FCA Board Members indicated that they would not proceed with the rule, and it was withdrawn.

Stockholder Vote on Like Lending Authority

In FY 2000, we proposed regulations to carry out territorial consent requirements of the Farm Credit Act of 1971, as amended. Section 5.17 of the Act requires FCS stockholders in certain areas of the country to vote on whether to allow other FCS associations with like lending



authorities to lend in their territories. If approved by the institutions covered by the Act, eligible customers would have the opportunity to borrow from more than one association. (Adopted May 3, 2000; published May 9, 2000 [65 FR 26776]) Subsequently, we reproposed the rule and requested additional comment. (Adopted July 20, 2000; published September 29, 2000 [65 FR 58486]) Early in FY 2002 (October 11, 2001), the FCA Board Members indicated that they would not proceed with the rule, and it was withdrawn.

Loans to Designated Parties
In FY 2001, we reproposed regulations governing the approval of loans to "designated parties," FCS "insiders" most likely to have conflicts of interest and FCA and FCSIC employees who are authorized to borrow from the System. (Adopted August 9, 2001; published September 18, 2001 [66 FR 48098]; comment period ended October 18, 2001) On March 12, 2002, the FCA Board withdrew the regulations for further consideration.

Policy Statement

Equal Employment Opportunity Programs and Diversity (FCA-PS-62)
The FCA Board adopted a policy statement affirming its commitment to Equal Employment Opportunity and Diversity (EEOD). The policy covers the employees, applicants for employment, and members of the public who seek to take part in FCA programs, activities, and services. The policy addresses affirmative employment and diversity, workplace harassment, and the disabled veterans affirmative action program. It also outlines the responsibilities of designated employees in developing and carrying out EEOD requirements and initiatives in accordance with laws and regulations. (Adopted September 12, 2002; effective September 12, 2002) Available for public inspection and copying on the FCA Web site.

Bookletter Guidance

Guidance for Involvement by Employees, Agents, and Board Members in the Nominating Committee Process (BL-043)
The Farm Credit Act and FCA regulations limit the involvement of association employees and board members in the process of nominating candidates for election to the board of directors. However, we noted that the nominating committee's function of identifying and selecting candidates for boards of directors is becoming more challenging as territories grow and memberships increase. Some associations were imposing unnecessarily restrictive limits on the nominating process. In response, we provided guidance in the Bookletter, issued on January 11, 2002, to help associations and their nominating committees better identify and select the most qualified candidates for boards of directors. We believe that this Bookletter assists in placing highly qualified board members in the critical position of directing FCS association affairs.

FCA's Conditions of Approval for the Agricultural Credit Association (ACA) Subsidiary Structure (BL-044)
We issued a Bookletter on April 3, 2002, concerning the conditions of approval under which ACAs and their subsidiaries operate. Specifically, we described how an ACA could allow its subsidiaries to acquire voting bank stock under the

bank's bylaws. We took this action after several System institutions noted that the prior condition prevented a subsidiary from acquiring bank voting stock and that an ACA and its subsidiaries were unable to make full use of their affiliated bank's capitalization bylaws. This condition of approval improves the economic rights of subsidiaries and the relationship to the ACA parent and/or their affiliated bank. The amended condition of approval continues to require the subsidiaries to transfer to the ACA any voting rights associated with holding stock in the bank.

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, 2002, the FCS issued $448 billion in debt, down from the $517 billion issued during the same period in 2001, primarily due to a decrease in discount note issuance.

Data Reporting

We continued our initiative to make financial and operational information about Farm Credit System institutions more accessible to the public. During the year, we made new analytical reports and additional operational data available to the public on the agency's Web site. The new analytical reports[4] include:

- the Uniform Peer Performance Report, which is a comparison report of one FCS institution to a group of FCS institutions of similar asset size,
- the Six-Quarter Trend Report and the Six-Year Trend Report, which show trend information for individual FCS institutions,
- the Institution Comparison Report, which is a comparison report of up to six selected FCS institutions, and
- the YBS Report, which provides annual data on the lending activities of FCS institutions for young, beginning, and small farmers and ranchers.

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. First South Farm Credit, ACA, subsequently intervened in the lawsuit, which challenged our final rule deleting the consent requirements for out-of-territory loan participations. On August 22, 2001, Judge Ricardo Urbina of the United States District Court for the District of Columbia granted our motion for summary judgment and denied the plaintiffs' motion for summary judgment. The case is currently on appeal in the United States Court of Appeals for the District of Columbia Circuit. All briefs have been filed, and oral argument took place on November 8, 2002.

4. The reports present information in various relational formats, including key financial ratios, percentages, and dollar amounts. The reports show a condensed balance sheet and income statement, as well as other areas on capital, assets, earnings and profitability, and liquidity.

Oversight of Farmer Mac

Farmer Mac is a federally chartered instrumentality of the United States created in 1988 to establish a secondary market for agricultural real estate and rural housing mortgage loans. 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, or obligations backed by qualified loans, that are not guaranteed by any instrumentality or agency of the United States. 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.

Farmer Mac is regulated by FCA through the Office of Secondary Market Oversight (OSMO), which was established in 1992, as required by Public Law 102-237. OSMO provides for the examination and general supervision of Farmer Mac's safe and sound performance of its powers, functions, and duties. The statute prescribes that OSMO constitute 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 2002, the agency, through OSMO, continued to examine and supervise Farmer Mac's operations and condition for safety and soundness and mission achievement. This included a comprehensive annual examination, supervision of Farmer Mac's implementation of the risk-based capital rule and stress test, with which Farmer Mac was required to be in compliance by May 23, 2002, and ongoing supervision of its operations and condition throughout the year.

On September 30, 2002, Farmer Mac's net worth was $195.5 million, compared with $129.7 million a year earlier. Its core capital (the sum of the par value of outstanding common stock, the par value of outstanding preferred stock, paid-in capital, and retained earnings) remained above the statutory minimum requirement, and its regulatory capital (core capital plus the allowance for losses) exceeded the required amount of regulatory capital as determined by the risk-based capital rule and stress test. On September 30, 2002, Farmer Mac's allowance for losses totaled $19.1 million, compared with $14.7 million on September 30, 2001. For the nine-month period ended September 30, 2002, net income was $18.5 million, up $7.7 million, or 71.5 percent, for the same period in 2001.

Farmer Mac's on- and off-balance sheet program activity continued to increase, reaching $5.2 billion on September 30, 2002, up $1.2 billion from a year earlier. A significant portion of Farmer Mac's recent growth has come from its Long-Term Standby Commitment to Purchase (LTSCP) program. Under the LTSCP program, a financial institution acquires a Farmer Mac commitment to purchase on a defined pool of loans for an annual fee paid to Farmer Mac. Farmer Mac commits to purchase (a) loan(s) from the pool under certain specified conditions, at the request of the institution.

On September 30, 2002, Farmer Mac I loans purchased, guaranteed, or committed to be purchased under its LTSCP program since the enactment of the Farm Credit System Reform Act of 1996 (1996 Act) that were seriously delinquent amounted to $91.3 million, or 2.03 percent of the principal balance of all post-1996 Act loans. This compares with $71.7 million, or 2.16 percent, on September 30, 2001. (Farmer Mac assumes 100 percent of the credit risk on post-1996 Act loans whereas pre-1996 Act loans are supported by mandatory 10 percent subordinated interests that mitigate Farmer Mac's exposure. Seriously delinquent loans are those that are 90 days or more past due, in foreclosure, in bankruptcy, or real estate owned.) There is an increasing trend in the total dollar amount of seriously delinquent loans during the first and third quarters. Farmer Mac reports that this reflects the maturing of a significant segment of its portfolio into its peak default years, and that higher delinquencies may be noted during the first and third quarters due to the semiannual payment structure of most Farmer Mac loans. The percentage of seriously delinquent loans for the first and third quarters has leveled off due to the overall growth in the Farmer Mac I portfolio. Nevertheless, the agency continues to monitor the amount and percentage of these seriously delinquent loans closely.

Audits, Inspections, Reviews, and Investigations

Audits

The Office of the Inspector General (OIG) conducted three audits and four inspections during FY 2002. An audit of the Office of Chief Financial Officer (OCFO) evaluated whether the OCFO was operating efficiently and whether initiatives to improve the office have been effective. Although the Federal Financial System is a promising step toward improving the OCFO efficiency, elements to ensure effective operation were lacking. Management agreed to develop a workforce planning strategy, improve staff skills, provide timely financial data, and manage expenditures more efficiently.

An audit of the FCA Contracting Activity was performed. The objectives were to determine whether FCA's contracting environment and process provide adequate controls and safeguards to prevent fraud, waste, and abuse. To create further efficiencies, management agreed to promote competition, validate needs, review contract files, track contractor costs, update policy and procedures, and review staffing to see whether it could be further streamlined.

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, 2002. The report was issued December 6, 2002. FCA received an unqualified opinion.

Inspections

An inspection of the Personnel Security Program followed seven suggestions made in 1999 to improve the program. Management agreed to place greater emphasis on the program and update sensitivity levels and follow more closely the policies in place.

The Leave Bank Program was inspected to determine whether it is administered according to internal guidelines. OIG found that the Leave Bank Program is sound and has accomplished its purpose. The value of the leave bank balance is properly reflected in the agency's financial records. There were no recommendations for management.

The Purchase Card Program was inspected to see how effectively government purchase cards are used. The agency agreed to improve the Purchase Card Program by further educating cardholders, performing internal reviews, and improving standard operating procedures.

An inspection of the Bar Status of the attorneys in the agency was performed. FCA attorneys are members in good standing of state bars. Management agreed to require documentation to prove bar membership before an offer of employment and to conduct periodic reviews to verify Bar Status.

Review and Study

During FY 2002, OIG completed its second annual review under the Government Information Security Reform Act. OIG contracted with Clifton Gunderson LLP to perform the review. No material weaknesses were discovered in the information security at FCA.

OIG also contracted with Declos/Walsh Associates to study the Early Warning System used by the Office of Examination. The study found that the system was a quality control tool rather than a mechanism that predicts future quality conditions. Suggestions to help the agency leverage its investment in the Early Warning System were made.

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.

Surveys

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 2002, OIG mailed 96 surveys and received 77 responses. This overall response rate for FY 2002 was slightly more favorable than the overall response rate of 1.61 in FY 2001. The average response rating for all questions answered this fiscal year was 1.51 on a scale of 1 to 5, with 1 meaning completely agree and 5 meaning completely disagree.

OIG also manages a survey aimed at obtaining information about the effectiveness of the FCA Regulatory Development Program.[1] OIG surveys stakeholders and other interested parties. OIG sent out 1,437 surveys. There were 297 responses, a 20.7 percent return. Both the return rate and the results were less favorable than the survey conducted in 2000.

Investigations

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. One investigation was open at the beginning of FY 2002; four additional investigations were opened during the year. Two were unsubstantiated and closed. There are three open investigations at the conclusion of FY 2002. Prosecution was declined for one criminal referral made to the U.S. Attorney's Office, and the matter has been referred to management for administrative sanctions.

The OIG Hotline (1-800-437-7322 or 703-883-4316 in the Washington, D.C., area) and the e-mail Hotline (fcaighotline@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.

1. The report, "Regulatory Development Survey," Office of Inspector General, October 2002, is available on FCA's Web site.

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 proactive, 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 the agency'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 and implementing 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.

Consistent with our desired outcomes, the Board adopted the following 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.

FCA's Strategic Plan contains seven objectives designed to provide additional direction and guidance. In this section, we address the 11 performance measures used to determine whether we have accomplished these objectives. The tables that follow describe the performance measures for each goal, the targets that reflect the agency's desired performance for fiscal year 2002, and the agency's actual results.

During FY 2002, our work focused on implementing initiatives to accomplish FCA's strategic goals and on measuring the agency's performance. We are committed to improving efficiency, minimizing the cost burden on FCS borrowers, and helping the agency's customers meet the challenges and opportunities of the future.

We were successful in meeting or exceeding all but two of FCA's performance measures. First, we completed seven of the nine regulatory projects scheduled for FY 2002 for a 78 percent completion rate, which fell short of our goal of 90 percent or more. Achieving this goal is particularly challenging because it requires us not only to determine the number of regulatory projects to be completed during a 12-month period, but also to predict which

specific actions will be completed. Second, the performance measure for customer acceptance of recently adopted FCA regulations and policies was not met. Part of the reason for this is that the Office of Inspector General sends its annual survey to all commenters on proposed regulations and policies. During this survey period, more non-System entities commented and were more critical of the agency in this area than were commenters from the System. This is an area that we will focus on improving during 2003.

Strategic Goals, Objectives, 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 the System's ability to provide competitive and dependable credit and related services for agriculture and rural America. To evaluate FCA's performance in these areas, we developed three agency-level performance measures for effective regulation and public policy (see Table 10a, page 66). Along with these performance measures, FCA's Strategic Plan has four objectives that provide additional direction and guidance for the agency's activities in support of this goal.

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

In order to enable the System to better serve all potential customers, FCA published an Advance Notice of Proposed Rulemaking regarding young, beginning, and small farmers and ranchers. With this ANPRM, we invited the public to comment on guidelines for YBS policies and programs that we may propose for the System. We also asked how we should measure, report, and publicly disclose the System's YBS performance. We believe that seeking the public's input is a valuable step in ensuring that the System maintains comprehensive YBS policies and programs that have a reasonable likelihood for sustained success. FCA also released YBS data through its Web site to enhance reports on the System's performance in this important mission service area. We believe that this improves transparency while providing timely information to all at no cost.

One of the three performance measures mentioned above is completion of at least 90 percent of the rulemaking projects scheduled in the Regulatory Performance Plans for the fiscal year.[1] As previously noted, in FY 2002, we completed seven of the nine rulemaking projects (78 percent) scheduled, which was 12 percentage points less than our performance measure target. However, in FY 2002, we completed and published the ANPRM regarding YBS (discussed above), which was not scheduled in the Regulatory Plan, bringing the number of completed rulemaking projects to eight.

The other seven rulemaking projects were completed as follows: (1) three rulemaking projects were withdrawn – National Charters, Stockholder Vote on Like Lending Authority, and Loans to Designated Parties; (2) three rulemaking projects were published as final—Loan Purchases and Sales, Electronic Commerce, and Termination of Farm Credit

1. Completion for the purposes of this performance measure means that the FCA Board has made a final determination on a rulemaking project. A completed project would include adopting a rule as proposed, adopting a rule in final, or withdrawing a rulemaking.

Status; and (3) one rulemaking project was published as proposed for comment—Capital Amendments. The projects we did not complete were proposed initiatives regarding Other Financing Institutions and Distressed Loan Restructuring. Work continues on these initiatives, and the projects are projected for FCA Board action during FY 2003.

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

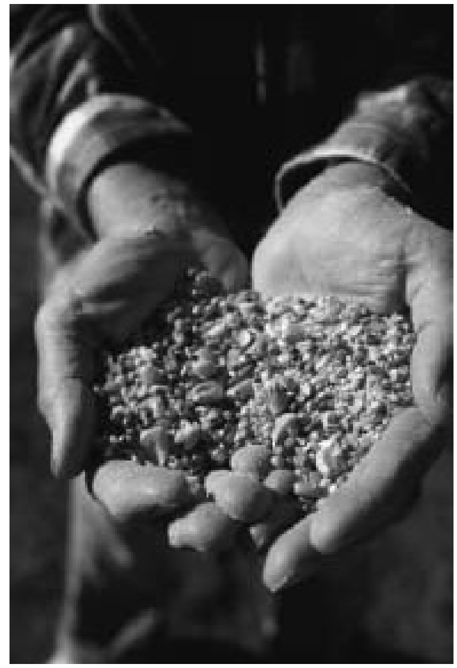
A second performance measure is using "special" (as defined in Table 10a) customer focus or features on 40 percent or more of the rulemaking actions taken. We used such features on 100 percent of the rulemaking actions taken by our Board in FY 2002. Five of the rulemaking actions came about because of petitions (National Charters, Loan Purchases and Sales, Loans to Designated Parties, Electronic Commerce, and Capital Amendments). Also, three of the rulemaking actions were written in question and answer format (Electronic Commerce, Stockholder Vote on Like Lending Authority, and Loans to Designated Parties). Finally, we extended the comment periods on two of our rulemaking projects (Termination of Farm Credit System Status and National Charters).

Among the rulemaking initiatives that support this objective is the proposed Capital Amendments rule. This proposed rule clarifies the circumstances under which FCA may waive disclosure requirements for issuances of equities and whether certain stock issuances count as permanent capital. Should the proposal become a final rule, FCS institutions can save time and money by having guidance and clarification at hand regarding disclosures or permanent capital computations.

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 FCA regulations. FCA solicited customer feedback via an Office of Inspector General survey. The survey is conducted by the Inspector General in order to help preserve its independence and confidentiality. The survey 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 by seeking its perspective regarding our rulemaking activities?
3. Did our rulemaking and policy activities implement the Farm Credit Act without imposing unnecessary burden?

Respondents answered these questions using a rating scale of 1 to 5, with 1 being the best rating. Our target was to earn an average rating equal to or less than 2.5. At the end of fiscal year 2002, the FCA Inspector General conducted a survey of 1,437 constituents (FCS institutions and commenters on regulatory actions taken by FCA during FY 2001 and FY 2002). The ratings for questions 1, 2, and 3 were 3.20, 2.98, and 2.97, respectively, for an overall average of 3.05. We are in the process of evaluating the survey responses to determine possible actions to reach our target.



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

In order to enable the System to serve evolving customer needs, we adopted the Loan Purchase and Sales final rule. Eliminating unnecessary regulatory restrictions that may have impeded effective participation relationships between System institutions and non-System lenders allows FCS institutions to better use existing statutory authority. Now System lenders have greater flexibility to buy loan participations from non-System lenders under certain conditions. Through the final Electronic Commerce regulations, we ensure that System customers can save time and other resources by using technological advances in lending. System customers living in rural areas should benefit greatly by using e-commerce. Finally, the final Termination of Farm Credit System Status regulation describes how any FCS lending institution can apply to terminate its charter and become a financial institution under another federal or state chartering authority. This opportunity for an FCS institution to change its charter may best serve the needs of institution borrowers.

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 2002, we reviewed Farmer Mac's implementation of the final capital rule that establishes Farmer Mac's risk-based capital requirement. The rule requires additional capital if loan portfolio and/or interest rate risks increase. Farmer Mac had to comply with the new risk-based capital requirement beginning May 23, 2002. Based on this review, we were able to ensure that Farmer Mac's first official application of the rule's stress test for the quarter ended June 30, 2002, was performed in accordance with the rule's specifications. Also, FCA, acting through OSMO, maintains ongoing oversight of Farmer Mac's operations and financial performance and condition, and provides for the annual examination of Farmer Mac regarding its safety and soundness and compliance with laws and regulations. These combined regulatory measures help 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 examining and supervising the safety and soundness of the Farm Credit System. To evaluate our performance in this area, we developed nine agency-level performance measures for effective examination and supervision. Along with these performance measures, FCA's Strategic Plan has three objectives that provide additional direction and guidance 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 correcting problems, by requiring remedial actions by institutions when we discover unsafe or unsound conditions or violations of law and regulations. Of the reports issued during FY 2002, the majority of the corrective actions required of FCS institutions was for regulatory compliance issues, rather than safety and soundness.

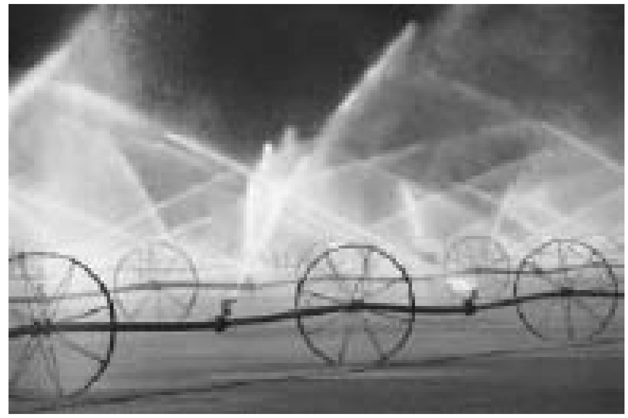
We maintained our dynamic Financial Institution Rating System that indicates the safety and soundness threats in an institution. This process includes evaluating the risk in each bank and direct-lender institution every 90 days to make sure that assigned ratings reflect current risk and conditions in the System. For three consecutive quarters, the FIRS updates (at March 31, June 30, and September 30, 2002) reflected more component downgrades than upgrades. Deterioration largely occurred in the earnings component, due primarily to the declining interest rate environment and the resulting lower return on the institutions' loanable equity.[2] In addition, provisions for losses were higher in the first half of 2002, compared with the same period in 2001. Finally, growth in earnings and capital had not kept pace with growth in assets in some associations, which prompted our downgrade of those components. Although FIRS ratings overall continue to reflect a healthy System, three consecutive quarters of component downgrades outnumbering component upgrades is a trend we will closely monitor, as it could reflect adverse affects of the rapid growth in System assets.

Semiannually, we use a financial forecasting model to identify and evaluate prospective risk in institutions over the next 12 and 24 months under "most likely" and "worst case" scenarios, respectively. The results of the most recent stress analysis indicated that there was probably not a material threat emerging in the System during the next 24 months, based on the expectation of continued government financial assistance and other assumptions provided by our field staff. The most recent stress analysis report was prepared using June 30, 2002, as a baseline, the most likely scenario at June 30, 2003, and the worst-case scenario at June 30, 2004.

We review and analyze new money, refinancing, and rollover trends semiannually to identify 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 recently issued report, evaluating trends from 1997 to 2001 among direct lenders in the FCS, did not reflect any material concerns with new loans, refinanced debt, or rollovers in calendar year 2001.

We use a three-tiered supervision and enforcement program (normal, special, and enforcement) to distinguish the risks and special oversight needs of institutions. Throughout FY 2002, all System institutions were under normal supervision. However, as a result of several regulatory compliance and management weaknesses identified during an examination, one institution at year-end 2002 is being considered for special supervision. Nevertheless, with all but one System institution under normal supervision, this status reflects generally sound conditions

2. Loanable equity refers to those funds available for lending which are not borrowed.



and positive board and management responses to examination concerns.

We maintain several internal information databases to support policy development, monitoring of emerging issues, and oversight of developing trends in agriculture. Key databases are Agricultural Prices, Farm Income, FCS Interest Rates, Trends in FCS and Commercial Loan Volume, Farm Debt/Market Share, and System Lending Information. These databases are a convenient and reliable source of information for staff to track and report to the FCA Board important agricultural economic and financial indicators.

We communicate expectations about emerging risks affecting the FCS. During FY 2002, FCA issued several Informational Memoranda. The topics addressed by these memoranda included spousal signature provisions of Regulation B, computer-based model validation expectations, and authenticating users of electronic banking services. FCA also provided alerts on fictitious transactions and unauthorized banking entities and orders of removal, suspension, or prohibition.

Objective 2 – Develop regulatory guidance and examination procedures that address new ventures of System institutions, including such areas as electronic commerce activities.

We provide regulatory guidance to the FCS on important subjects, including examination focus areas. The examination focus areas are implemented through prescribed examination procedures and institution self-audit questionnaires. Expectations for electronic commerce activities were included in these examination focus areas.

In support of the electronic commerce focus area, three examination programs (leadsheets) were developed to assist examiners. The leadsheets were designed to help determine whether an institution has taken appropriate actions to ensure the safety of its information and protect the institution and its borrowers. In addition, to assist System institutions in completing their assessments of this area, FCA developed and disseminated a self-audit questionnaire on e-commerce. Examinations completed in FY 2002 found that most FCS institutions had taken appropriate actions to ensure the safety of their information and were responsive to recommendations from examiners regarding improvements to controls over information.

We conduct centralized reviews of FCS Web sites semi-annually. The reviews include all active Web sites, some of which are used by multiple institutions. Despite a decline in the number of total FCS institutions, the number of Web sites has increased modestly, and a majority of institutions now have their own or shared Web sites. A key part of these reviews is evaluating adherence to our November 8, 1999, Informational Memorandum, “Web Site and Internet Guidelines.” However, the reviews also assess the use of advertising by other entities on FCS Web sites and the use of those Web sites to promote lending to YBS farmers and ranchers. The most recent review concluded that institutions continue to make progress in the use of their Web sites. However, there were a few Web sites without all the necessary legal requirement disclosures, and, with a few exceptions, FCS institutions as a group were not putting forth adequate efforts to promote YBS lending programs on their Web sites. To facilitate progress, we continue to issue guidance and communicate directly with institutions having specific deficiencies identified by our reviews.

On March 21, 2002, the FCA Board approved a final rule on electronic commerce. This rule created new part 609 (Electronic Commerce) and amended part 620 (Disclosure to Shareholders) to allow electronic disclosures. These changes reflect emerging business approaches to electronic commerce. The rule serves to remove regulatory barriers to electronic commerce and create a flexible regulatory environment that promotes the safe and sound use of new technologies by System institutions and their customers. Included with the rule is a brief outline of federal laws and regulations that facilitate electronic commerce.

On July 26, 2002, we issued an Informational Memorandum providing specific guidance on electronic disclosures and notices. As FCA's electronic commerce regulation provides only broad guidance on electronic commerce issues, this Informational Memorandum responded to specific questions regarding electronic disclosures and notices posed to FCA by System institutions during the proposed rulemaking on electronic commerce.

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

FY 2002 examinations focused additional attention to mission performance by the FCS, particularly in the service to young, beginning, and small farmers and ranchers. In addition, a new internal performance measure was implemented for FY 2002 to focus additional attention on this important area.

Examiners completed a standard examination leadsheet for the FY 2002 examination focus area of YBS farmers and ranchers. The leadsheet facilitates an evaluation of an institution's program and practices in implementing and reporting on YBS lending programs and related services. Specifically, the YBS leadsheet requires examiners to evaluate the institution's related policies and procedures, lending programs, risk management, business and marketing programs, coordination with governmental or private sources of credit, and the accuracy of its database and reporting. In addition, the leadsheet requires the examiners to evaluate 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 to address any existing disparities. Comprehensive completion of the YBS leadsheet was mandatory on all FY 2002 FCS examinations. Examinations completed in FY 2002 found that all institutions had programs for serving YBS farmers and ranchers as required by statute and regulation. Also, the majority of the programs were considered "satisfactory" when measured against our Bookletter and FCA Board policy guidance. Nevertheless, examiners have made recommendations for improvement to many institutions regarding their YBS programs. Accordingly, we will continue to focus attention on this important area.

Business planning was an examination focus area in FY 2002. In support of this focus area, a leadsheet was developed to assist examiners. The leadsheet was designed to help determine whether management has taken appropriate actions to implement proper strategies to accomplish an institution's public mission in a safe and sound manner. Specifically, the business planning leadsheet includes an evaluation of whether an institution is achieving its public mission to serve agriculture and rural America, including specific efforts to serve YBS farmers and ranchers. The leadsheet requires examiners to give particular scrutiny to the quality of the institution's plans to serve its territory by evaluating whether it:

- Describes all segments of the existing market (including both existing and potential customers),
- Evaluates how well the institution is currently serving each segment of its existing market (including both existing and potential customers),
- Assesses underserved segments in the institution's existing market,
- Assesses the institution's capacity to serve all segments of its existing market (including both existing and potential customers) and any constraints on this capacity, and

- Describes the strategies the institution will pursue to ensure that it provides adequate service within its territory.

Completion of the business planning leadsheet was mandatory on all FY 2002 FCS examinations. Examinations completed in FY 2002 found that most FCS institutions had adequately defined and communicated their public mission consistent with the Farm Credit Act. However, examiners continued to make recommendations to many institutions regarding their measurement and goals for market share, particularly to the YBS sectors.

We facilitated the collection of data measuring the System's progress in serving YBS farmers and ranchers. Based on the statute and FCA policy direction, every year System banks provide quantitative and qualitative YBS data for affiliated associations and the bank. System banks also provide district summaries of YBS lending. Much of this information is available to the public on our Web site at www.fca.gov.

As Table 10b on pages 67 and 68 shows, we successfully met or exceeded all applicable targets for performance measures 4 through 9. The results for performance measures 4 through 9, which address the System's risk, capital adequacy, and earnings, reflect 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 correct identified weaknesses.

The two-part table that follows contains the measures for each outcome with the goals and objectives that reflect the agency's desired performance for fiscal year 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 2002 target for that goal.
✓	indicates that FCA achieved the target.
▼	indicates that FCA did not achieve its target for that goal.
N/A	not applicable indicates that FCA's target against that goal could not be measured.

Table 10a

Goal 1

FY 2002 Performance Measures and Results

Description	Measure	FY 2002 Target[1]	FY 2002 Result	FY 2002 Result vs. Target
1. Customer acceptance of recently adopted FCA regulations and policies through the average of ratings received on the following survey questions (on a scale of 1 to 5, with 1 being the highest rating):	At the end of fiscal year 2002, the FCA Inspector General (IG) conducted a survey of 1,437 constituents (FCS institutions and commenters to regulatory actions we made during FY 2001 and 2002). The IG received 297 responses. The average overall rating for the three questions in this measure was 3.05. The average rating for each question was:	≤2.50	3.05	▼
• Did our rulemaking and policy activities recognize market forces and encourage innovation for System institutions?	3.20			
• Did we adequately involve the public to seek its perspective regarding our rulemaking activities?	2.98			
• Did our rulemaking and policy activities implement the Farm Credit Act without imposing unnecessary burden?	2.97			
2. Percentage of regulations completed that use "special" customer service focus or features.[2]	Special customer service focus or features were used on all completed regulations.	≥40%	100%	▲
3. The total number of regulatory projects completed compared to the number of regulation projects in the Board-approved annual Regulatory Performance Plan.	Seven of the nine (78%) regulatory projects planned according to the October 2001 and April 2002 Regulatory Performance Plans were completed during 2002. However, during FY 2002, the agency completed one additional regulatory project.	≥90%	78%	▼

1. The following defines the symbols and abbreviations used to describe targets in the Performance Measures and Results table: < is less than; > is greater than; ≤ is less than or equal to; ≥ is greater than or equal to; and N/A is not applicable.
2. "Special" customer service focus or features are designed to enhance the public's ability to participate in regulatory projects or to expedite completion of projects when appropriate. These include: Advance Notice of Proposed Rulemaking; 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 and/or Congressional Committees.

Table 10b

Goal 2

FY 2002 Performance Measures and Results

Description	Measure	FY 2002 Target[1]	FY 2002 Results	FY 2002 Results vs. Target
4. The number of direct-lender institutions with adversely classified assets to risk funds less than 100 percent divided by the total number of direct-lender institutions.[3]	All FCS institutions maintained adversely classified assets (loans with the highest risk of default) at levels that were well within their risk-bearing capacity. The amount of risk funds (funds available to absorb losses, i.e., capital plus the allowance for loan losses) substantially exceeded the amount of adversely classified loans in all FCS institutions.	100%	100%	✓
5. The total assets of direct-lender institutions with adversely classified assets to risk funds less than 100 percent divided by the total assets of direct-lender institutions.	All FCS institutions maintained adversely classified assets (loans with the highest risk of default) at levels that were well within their financial risk-bearing capacity. The amount of risk funds (funds available to absorb financial losses, i.e., capital plus the allowance for loan losses) substantially exceeded the amount of adversely classified loans in all FCS institutions.	100%	100%	✓
6. The number of direct-lender institutions with adversely classified assets to risk funds greater than 100 percent with corrective action plans that mitigate the excessive risk.	This measure is not applicable because none of the FCS institutions had adversely classified assets to risk funds greater than 100 percent. Therefore, corrective action plans were not needed at any institutions.	100%	N/A	N/A
7. The total assets of direct-lender institutions complying with all capital ratio requirements.	FCA has established several regulatory minimum capital requirements for FCS institutions. All FCS institutions remained well capitalized and were in full compliance with all regulatory minimum capital requirements.	100%	100%	✓
8. The 3-year average return on average assets (ROAA) of FCS institutions.	ROAA measures total net income relative to the size of the FCS' asset base. The FCS' profitability remained satisfactory and the ROAA exceeded our target level.	≥1.25%	1.68%	▲
9. The 3-year average return on equity (ROE) of FCS institutions.	ROE measures total net income relative to the size of the FCS' capital base. The combined income of the FCS provided a satisfactory return on owners' equity. The ROE exceeded the level of return shareholders would have received from investing in 10-year Treasury bonds plus a 200 basis point risk premium.	>7.34%[4]	10.84%	▲

3. 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 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.
4. 10-year Treasury bond rate of 5.34% plus 2% = 7.34%

Table 10b

Goal 2

FY 2002 Performance Measures and Results

Description	Measure	FY 2002 Target[1]	FY 2002 Results	FY 2002 Results vs. Target
10. The percentage of examinations of FCS institutions meeting the statutory examination frequency requirement.	The agency is required by statute to examine each FCS institution at least once every 18 months. All examinations were completed in compliance with the statute.	100%	100%	✓
11. 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).	FCA's Inspector General conducts a semi-annual survey of FCS institutions that were examined during the previous 6-month period. The survey provides us feedback on whether the board and management believe our examination provided them useful information.			
• The board and management believe the findings of the examination will assist (or have assisted) the institution in correcting identified weaknesses.	For FY 2002, the ratings received were better than our target level.	≤2.25	1.70	▲
• The board and management believe the actions required by the enforcement document will assist (or have assisted) the institution in correcting identified weakness.	This question was not applicable for FY 2002 because no FCS institutions were under enforcement action.	<2.5	N/A	N/A

Farm Credit Administration Management Systems, Controls, and Legal Compliance

This section provides information on FCA's compliance with the

- Inspector General Act,
- Federal Financial Management Improvement Act (FFMIA),
- Prompt Payment Act,
- Civil Monetary Penalty Act, and
- Debt Collection Improvement 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 2002 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. A recommendation often includes these agreed-upon actions.

Summary of Audit and Inspection Recommendations
October 1, 2001, to September 30, 2002

Recommendations uncorrected as of October 1, 2001	16
Recommendations made during FY 2002	32
Recommendations corrected during FY 2002	38
Open recommendations at September 30, 2002	10
Recommendations open more than one year	4

Summary of Audit Activities for FY 2002

At the beginning of FY 2002, there were 16 unimplemented recommendations. Twelve were from the audit report of Performance Budgeting, issued on March 23, 2001, and four were from the inspection report of FCA's Affirmative Employment Program Action Plan issued May 23, 2001.

OIG issued three audit reports and four inspection reports, one review under the Government Information Security Review Act, and one Study on the Early Warning System during FY 2002. These reports contained a total of 32 recommendations.

During this reporting period, management worked with OIG to close 38 recommendations.

At the end of the FY 2002 reporting period, there were 10 agreed-upon actions remaining open. Four agreed-upon actions are from the audit of Performance Budgeting issued March 23, 2001. Three agreed-upon actions are from the audit report on the Office of Chief Financial Officer issued January 24, 2002. Two agreed-upon actions are from the audit report on FCA Contracting Activity issued August 27, 2002. One agreed-upon action is from the Government Purchase Card Program Inspection issued September 9, 2002. 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 federal financial management system requirements for FY 2002.

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 2002, 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 $1,119.96 in interest penalties for the payments that were not processed on time. Payments are made by electronic funds transfer.

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 2002.

Debt Collection Improvement Act

The Debt Collection Improvement Act prescribes standards for the administrative collection, compromise, suspension, and termination of federal agency collection actions, and referral to the proper federal agency for litigation. Although the Act has no material effect on the FCA since it operates with virtually no delinquent debt, the agency does transfer debts more than 180 days old to Treasury for cross-servicing.

The Chairman's Letter of Assurance

December 6, 2002

On behalf of the Farm Credit Administration, I am presenting the agency's Performance and Accountability Report for FY 2002. The report describes the agency's mission, goals and accomplishments. The report also includes the agency's financial statements and other key information. I am pleased to report the significant accomplishment of receiving an unqualified audit opinion for the ninth year in a row.

Based on internal management evaluations, and in conjunction with the results of independent financial statement audits, the agency can provide reasonable assurance that the objectives of Section 2 (internal controls) of the Federal Managers' Financial Integrity Act (FMFIA) have been achieved. The agency can also provide reasonable assurance that the objectives of Section 4 (financial management systems) of FMFIA have been achieved as the agency's financial systems conform with government-wide standards.

The unqualified auditor's opinion on the agency's financial statements speaks to their completeness and reliability.

Sincerely,

Michael M. Reyna
Chairman and CEO
Farm Credit Administration

Farm Credit Administration Financial Statements

Farm Credit Administration

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

January 8, 2003

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 (FY) ended September 30, 2002. This letter also incorporates a summary of what I believe are the most significant management and performance challenges facing the agency as described in the Office of Inspector General (OIG) Semiannual Report to Congress dated September 30, 2002.

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, 2002 and 2001, 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 6, 2002 opinion and we concur with the report.

As part of the agency Performance and Accountability 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.

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

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 professional policy debate and set a sound course for the agency.

The Board is in an important period of transition. On August 6, 2002, the Board returned to full strength ending a 19-month period with only two Board members. In November 2002, Nancy C. Pellett replaced Ann Jorgensen whose term had expired. The return to a full strength Board is an important element in setting clear priorities and deliberating fully on the issues coming before the Board.

A relatively small, full-time Board also presents a challenge in terms of defining the roles and responsibilities of the Board members relative to the governance of the agency. As the membership on the Board changes, it needs to update its rules of operation to ensure it fulfills its statutory role in the governance of FCA.

Strategic Planning – The FCA Strategic Plan was updated and revised in FY 2000 to reflect the FCA Board's priorities at that time. The current FCA Strategic Plan reflects an environment that has changed significantly since it was adopted — the composition of the Board, the economy, the structure of the FCS, and the President's Management Agenda. The FCA Board's challenge is to take a fresh look at the substance of FCA's mission, goals, and objectives. The Board will have the opportunity to set a course for FCA that focuses on the results that it wants to achieve through clear and balanced performance measures. The change in the Board's composition will allow the new Board to develop a new perspective that is not unduly constrained by past practices but builds on the experience of prior Boards.

Human Capital – The President identified human capital as a critically needed management reform in the federal government. FCA needs to develop a comprehensive, integrated approach to human capital issues. In light of the changes in the competitive environment, advances in technology, and the tenure of its workforce; the agency will be challenged to closely evaluate business processes, their associated costs, and alternatives available through competitive sourcing. The General Accounting Office's (GAO) High-Risk report outlines four pervasive human capital challenges that the government faces:

- planning strategic human capital and organizational alignment;
- planning for succession and leadership continuity;
- acquiring and developing staffs whose size, skills, and deployment meet agency needs; and
- creating results-oriented performance cultures.

Financial Management – Last year, FCA successfully implemented a new financial management system using the services of the Department of Interior's National Business Center. FCA received an unqualified audit opinion. However, financial management success goes beyond an unqualified financial statement audit opinion. Management's challenge is to leverage the system to deliver timely financial information that is critical for making well-informed management decisions. Meeting this challenge requires new measures of success: measures such as delivering financial information that managers can use for day-to-day operations; and developing reports that capture the full cost of programs and projects can help bring about a transition.

Security – In the recent report on information security, the OIG 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; therefore, security remains a major challenge for the agency.

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

Respectfully,

Stephen G. Smith
Inspector General

Letter from the Chief Financial Officer

This performance and accountability report provides an accurate and concise portrayal of the condition and performance of the Farm Credit Administration (FCA). As stated throughout the report, FCA has made productive use of its financial resources by doing more with less. The achievements cited indicate the wide range of FCA's responsibilities and the emphasis that has been and will continue to be placed on effective financial management and reporting.

Fiscal year 2002 marks the first year that FCA operated fully under the Federal Financial System, the agency's core accounting system. The Federal Financial System was developed and is licensed by the American Management Systems, Inc. It was implemented on an interim basis in June 2001 to provide FCA with 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. Since that time, FCA has focused on fine-tuning the system and expanding its reporting and electronic capabilities. During FY 2002, an electronic travel-booking tool was implemented throughout FCA. The travel-booking tool allowed travelers to make airline, hotel, and car rental reservations online. More than 98 percent of FCA staff was trained on its use. To further enhance the travel process, FCA will implement an off-the-shelf travel management system. The travel management system will interface with both the travel-booking tool and the Federal Financial System; thereby, creating a seamless travel process that should be deployed throughout FCA in FY 2003.

Although the agency received an "unqualified" opinion, there are still needed improvements in the financial management area. Such improvements include the capability to capture and report financial information on a timelier basis, to automatically produce the financial statements and other reporting needs, and to provide users with data that are readily available, easily accessible, and simple to understand. Within the next few years, FCA will need to transition to a newer, state-of-the-art financial management system. American Management Systems, Inc. has indicated that they will not seek recertification of the Federal Financial System by the Joint Financial Management Improvement Program when the current certification expires. American Management Systems, Inc. is no longer marketing the Federal Financial System; instead they are focusing their attention and resources on a new financial management system. American Management Systems, Inc. has also indicated that they will cease to provide an annual maintenance program for this software in the 2004–2005 timeframe. Prior to that, FCA will work on the replacement of the Federal Financial System with a more modern, fully integrated financial management system. This replacement system effort, along with our ongoing automation initiatives will be a positive step toward ensuring FCA's ability to meet its current and future financial management information needs.

W. B. Erwin
Chief Financial Officer

Financial Highlights

Financial Operation of the FCA

FCA operates under the authority of the Farm Credit Act of 1971, as amended. FCA maintains a revolving fund in which moneys are obtained primarily from assessments received from the Farm Credit System institutions and the Federal Agricultural Mortgage Corporation and moneys for reimbursable services provided to other government agencies. FCS institutions and Farmer Mac are assessed and charged directly or billed in accordance with a formula established by FCA regulations. Assessments and other income earned in excess of obligations are refunded or considered in determining the amount to assess System institutions in the subsequent fiscal year. Congress usually imposes a limitation on the amount of obligations that may be incurred in a given fiscal year from assessments collected from FCS institutions and from Farmer Mac.

FCA's Assets, Liabilities and Net Position

FCA's assets as of September 30, 2002, totaled $22,561,373, of which $20,980,860 or 93 percent was invested in one-day and three-year marketable securities. Based on Section 5.15 of the Act, the FCA only invests with the Department of Treasury funds that are in excess of the amounts necessary for current expenses. Considering immediate cash needs, at the end of the fiscal year, uninvested funds equal $229,383. At the end of FY 2001, there was an uninvested fund balance of $752,291 and investments totaling $19,986,030.

For FY 2002, the year-end liabilities reported was $8,021,523 compared with $9,835,785 reported for FY 2001. This decrease is due to a liability of $2.1 million that was established for assessment refunds in FY 2001 but were not paid until FY 2002. Other significant liabilities for both FYs 2002 and 2001 included employee benefits due and payable, the actuarial liability for Federal Employees' Compensation Act (FECA actuarial) benefits, and deferred revenue. The sum of these liability amounts represents more than 86.9 percent and 67.6 percent of the total liabilities due for FYs 2002 and 2001, respectively. Employees' leave balances (except sick leave) and most other benefit costs are covered by budgetary resources. The benefits owed employees in FY 2002 totaled $3,327,173. This represents a decrease in benefits due of $723,554, from a $4,050,727 balance in 2001. Although the actuarial liability for $2,030,757 represents a large portion of the total liabilities, it is not covered by budgetary resources. The Statement of Federal Financial Accounting Standard No. 5 requires that the actuarial liability amount be reported since it represents the estimated amount that FCA will pay for future compensation benefits. The deferred revenue amounts of $1,611,366 for FY 2002 and $1,489,161 for FY 2001 represent assessments received from financial institutions within the FCS that are not yet due.

As a result of operations for the year, the net position increased by approximately 17.7 percent from $12,357,032 to $14,539,850. The increase in the cumulative results of operations is attributable to the amount of the imputed financing sources (monies paid by other organizations/agencies on behalf of the FCA) of more than $4.1 million and the net cost of operations of approximately $2 million.

FCA's Funding and Fund Sources
FCA maintains a revolving fund in which moneys are obtained primarily from assessments on System institutions and service corporations, reimbursable activities, and interest earned from investments with the Department of Treasury. The following chart depicts the funding that was available and/or collected by FCA for FYs 2002 and 2001.

FUNDING SOURCE	2002	2001
Assessments	$36,700,000	$36,800,000
Reimbursable Activity	1,213,379	877,244
Interest from Investments	485,301	1,068,465
Totals	$38,398,680	$38,745,709

As depicted in the chart, the total funds available in FY 2001 exceeded the funds available for FY 2002 by $347,029. While there was an increase in reimbursable activity of $336,135 (due to an increase in the scope of work performed), the interest earned from investments decreased by more than $583,164, and the assessments remained basically the same. The decrease in interest from investments reflects a drop in interest rates over the past 12 months caused by the downturn in the economy.

During the year, obligations incurred totaled $32,372,518, compared with $36,245,878 in FY 2001. This represents a spending level of 84.3 percent (total obligations to available annual funding) in FY 2002, compared with a spending level for FY 2001 of 93.5 percent. Although $2.1 million of the obligations incurred in FY 2001 were for assessment refunds made to System institutions, the decrease in obligations in FY 2002 for other items still decreased by more than 5.2 percent. As a result, the unobligated balance carryover in available funding increased from $10,439,654 to $13,941,462, or 33.5 percent.

Performance and Financial Results

The following commentary reviews the agency's performance and financial condition and results of operations of the FCA for the fiscal years ended September 30, 2002, and September 30, 2001. 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.

FCA met or exceeded most of its performance targets to promote a safe and sound, competitive Farm Credit System and Farmer Mac, and to perform reimbursable services for other government entities. In addition, FCA implemented initiatives for diversifying and improving the employee workplace during the fiscal year. The total cost of FCA programs in the Statement of Net Cost totaled $40,481,557 for 2002, up 5.2 percent or $1,986,400 from 2001. The rise in program costs primarily results from

increases in the FECA actuarial liability, imputed cost for federal employee benefits, and imputed rent for office space provided by the FCS Building Association. Earned revenues improved $2,096,438 from the previous year and mitigated the rise in costs. As a result, the net cost of FCA programs improved $110,038 to $1,953,084, which represents a 5.3 percent decrease.

Employees salaries and benefits comprise FCA's most significant cost. For 2002, employees salaries and benefits from payroll totaled $29,130,696 or 72 percent of FCA's total cost. These costs decreased $233,700 from the previous year with continued employee attrition and the consolidation of staff positions. The FCA expects staff attrition to increase over the next five years with almost 30 percent of its staff eligible to retire. However, management has implemented plans to recruit and train staff for positions that will be vacated by staff retirements and are essential to fulfilling the agency's mission and goals. In addition, FCA expects to increase its employee compensation to remain in conformance with the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) to keep FCA salaries comparable with those of other federal financial institution regulators. Management believes its plans for employee recruitment and compensation should ensure that FCA maintains a quality staff.

Safety and Soundness Program

FCA continues to examine and oversee institutions to ensure the safety and soundness of the FCS for the benefit of its shareholders. The Office of Examination met or exceeded its performance targets, completed all planned 2002 examinations, and monitored FCS institutions and Farmer Mac. The risk ratings of FCS associations and banks remained strong with 67 percent of the institutions having the lowest risk rating of 1 and 32 percent with a risk rating of 2. The effectiveness of FCA's risk-based examination and oversight of the FCS is further evidenced by a 2002 GAO review and report (see pages 35–39).

In addition to meeting its performance goals, FCA took steps in 2002 to add value to its examination and oversight to ensure that the FCS fulfills its statutory mission and complies with regulations to provide adequate and dependable credit for agriculture and rural America. The 2002 GAO review identified a need for program enhancements to ensure that the FCS complies with statutory requirements to provide adequate credit to young, beginning, and small farmers and ranchers (YBS). FCA increased its examination focus on institutions' compliance with YBS regulations. The expanded focus increased program cost $4,059,745 to $28,135,168 in 2002. It is too early to measure the full results of FCA program enhancements for FCS compliance. More FCS information will be available in 2003 to assess the effectiveness of FCA's program enhancements. Program cost for FCS safety and soundness represents 69.5 percent of FCA's total cost, compared with 62.5 percent for 2001.

Policy and Regulation Program

FCA worked to maximize the FCS opportunities to provide competitive and dependable credit for agriculture and rural America in its performance of corporate activities and regulation development. The program cost decreased by $3,216,072 to $9,302,047 because of a decrease in corporate activity and a reduction in the number of new regulations. The number of mergers of FCS banks and associations declined through 2002, and the trend is expected to continue in 2003 with a smaller number of remaining institutions in the FCS (see pages 49–51). The total number of banks and associations has declined by 108 institutions in the past two years. Most FCS institutions have merged to a new ACA parent/subsidiary structure that provides its shareholders a variety of loans and services. FCA continued to make progress in completing regulation projects though performance results were mixed in completing planned projects and achieving a desired level of customer acceptance of adopted FCA regulations and policies. The FCA completed an unplanned project for System YBS performance. Other projects were withdrawn after receiving public comment.

Other Activity

Reimbursable activity continued to increase with the SBA and USDA requiring more examination services. The increase occurred even though the Farm Credit System Insurance Corporation discontinued its agreement with FCA for accounting services. In 2002, revenue from Farmer Mac and reimbursable services increased 16.1 percent to $1,979,481 from 2001. However, the costs of providing these services totaled $3,044,342, up $1,142,727 from 2001. This rise resulted from increases in the agency's FECA actuarial and imputed cost for rent and employee benefits that were prorated according to staff time spent. Management has initiated actions to develop budget and operation reports. These actions should provide management with a better tool to track cost and revenue of reimbursable projects.

Limitations of the Financial Statements

The financial statements have been prepared to report the financial position and results of operations of the FCA, pursuant to the requirements listed in 31 U.S.C. 3515(b).

While the statements have been prepared from the books and records of FCA in accordance with accounting principles generally accepted in the United States (GAAP) for federal entities and the formats prescribed by the Office of Management and Budget, 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.

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 sheets of the Farm Credit Administration (FCA) as of September 30, 2002 and 2001, 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 audits.

We conducted our audits 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 audits 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 audits provide 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, 2002 and 2001, 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.

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Our audits were conducted for the purpose of forming an opinion on the FY 2002 and 2001 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; 7–9; 35–39; 56–70; and 76–79; and the Required Supplemental Information on pages 101–102 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 4–6; 10–34; 40–55; and pages 103–110 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.

Harper, Rains, Stokes & Knight P.A.

December 6, 2002

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 the Farm Credit Administration (FCA) as of and for the years ended September 30, 2002 and 2001, and have issued our report thereon dated December 6, 2002. We conducted our audits 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 audits, 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 audits 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

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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 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 6, 2002

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 years ended September 30, 2002 and 2001, and have issued our report thereon dated December 6, 2002. We conducted our audits 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.

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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.

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 audits 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 6, 2002

FINANCIAL STATEMENTS AND RELATED NOTES

FARM CREDIT ADMINISTRATION
BALANCE SHEETS
As of September 30, 2002 and 2001

	2002	2001
Assets:		
Intragovernmental:		
Fund Balance with Treasury (Note 2)	$ 229,383	$ 752,291
Investments (Note 3)	20,980,860	19,986,030
Accounts Receivable (Note 4)	63,334	370,319
Prepaid Expenses	54,293	2,496
Total Intragovernmental	21,327,870	21,111,136
Cash and Other Monetary Assets (Note 5)	-	1,500
Accounts Receivable, Net (Note 4)	322,713	157,597
General Property, Plant and Equipment, Net (Note 6)	861,597	904,990
Prepaid Expenses	49,193	17,594
Total Assets	$22,561,373	$22,192,817
Liabilities:		
Intragovernmental:		
Accounts Payable	$ 201,655	$ 169,493
Accrued Postemployment Compensation (Note 7)	187,857	361,084
Advances from Others	20,442	-
Employer Contributions and Payroll Taxes Payable	108,665	250,310
Total Intragovernmental	518,619	780,887
Accounts Payable	533,608	2,404,854
Actuarial Workers Compensation Liability (Note 8)	2,030,757	1,110,156
Accrued Payroll and Benefits	3,327,173	4,050,727
Deferred Revenue	1,611,366	1,489,161
Total Liabilities	8,021,523	9,835,785
Net Position:		
Cumulative Results of Operations	14,539,850	12,357,032
Total Net Position	14,539,850	12,357,032
Total Liabilities and Net Position	$22,561,373	$22,192,817

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

FARM CREDIT ADMINISTRATION
STATEMENTS OF NET COST
For the Years Ended September 30, 2002 and 2001

	2002	2001
Program Costs:		
Safety and Soundness:		
Intragovernmental Gross Costs	$ 6,822,396	$ 6,067,962
Less: Intragovernmental Earned Revenues	(364,718)	(702,960)
Intragovernmental Net Costs	6,457,678	5,365,002
Gross Costs with the Public	21,312,772	18,007,461
Less: Earned Revenues from the Public	(27,101,985)	(22,138,080)
Net Costs with the Public	(5,789,213)	(4,130,619)
Total Net Costs – Safety and Soundness	$ 668,465	$ 1,234,383
Policy and Regulation:		
Intragovernmental Gross Costs	$ 2,208,359	$ 2,386,159
Less: Intragovernmental Earned Revenues	(120,583)	(365,507)
Intragovernmental Net Costs	2,087,776	2,020,652
Gross Costs with the Public	7,093,688	10,131,960
Less: Earned Revenues from the Public	(8,961,706)	(11,510,789)
Net Costs with the Public	(1,868,018)	(1,378,829)
Total Net Costs – Policy and Regulation	$ 219,758	$ 641,823
Other Activity:		
Intragovernmental Gross Costs	$ 817,977	$ 487,722
Less: Intragovernmental Earned Revenues	(1,213,379)	(877,244)
Intragovernmental Net Costs	(395,402)	(389,522)
Gross Costs with the Public	2,226,365	1,413,893
Less: Earned Revenues from the Public	(766,102)	(828,227)
Net Costs with the Public	1,460,263	585,666
Total Net Costs – Other Activities	$ 1,064,861	$ 196,144
Costs Not Assigned to Programs	-	-
Less: Earned Revenues Not Attributed to Programs	-	(9,228)
Net Cost of Operations (Note 11)	$ 1,953,084	$ 2,063,122

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, 2002 and 2001

	2002 Cumulative Results of Operations	2001 Cumulative Results of Operations
Net Position - Beginning Balance	$12,357,032	$ 10,983,589
Other Financing Sources:		
Imputed Financing from Costs Absorbed by Others		
Federal Employee Benefits (Note 12)	1,833,910	1,559,592
Rent (Note 13)	2,301,992	1,876,973
Total Financing Sources	4,135,902	3,436,565
Net Cost of Operations	(1,953,084)	(2,063,122)
Net Position - Ending Balance	$14,539,850	$ 12,357,032

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

FARM CREDIT ADMINISTRATION
STATEMENTS OF BUDGETARY RESOURCES
For the Years Ended September 30, 2002 and 2001

	2002	2001
Budgetary Resources:		
Unobligated Balances - Beginning of Period	$ 11,928,815	$ 10,122,345
Spending Authority from Offsetting Collections		
Earned		
Collected	36,061,903	37,847,252
Receivable from Federal Sources	(186,588)	205,096
Change in Unfilled Customer Orders		
Advance Received	20,442	-
Without Advance from Federal Sources	100,774	-
Subtotal – Spending Authority from Offsetting Collections	35,996,531	38,052,348
Total Budgetary Resources (Note 12)	$ 47,925,346	$ 48,174,693
Status Of Budgetary Resources:		
Obligations Incurred – Exempt from Apportionment	$ 32,372,518	$ 36,245,878
Unobligated Balances-Available – Exempt from Apportionment	13,941,462	10,439,654
Unobligated Balances-Not Available	1,611,366	1,489,161
Total Status of Budgetary Resources	$ 47,925,346	$ 48,174,693
Relationship of Obligations to Outlays:		
Obligated Balance, Net, Beginning of Period	$ 8,793,789	$ 8,178,249
Obligated Balance, Net, End of Period:		
Accounts Receivable	$ (159,718)	$ (346,306)
Unfilled Customer Orders from Federal Sources	$ (100,774)	-
Undelivered Orders	$ 979,089	$ 1,906,469
Accounts Payable	$ 4,358,958	$ 7,233,625
Outlays:		
Disbursements	$ 36,174,565	$ 35,425,656
Collections	(36,082,344)	(37,847,251)
Net Outlays	$ 92,221	$ (2,421,595)

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

FARM CREDIT ADMINISTRATION
STATEMENTS OF FINANCING
For the Years Ended September 30, 2002 and 2001

	2002	2001
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations Incurred	$32,372,518	$36,245,878
Less: Spending Authority from Offsetting Collections	(35,996,531)	(38,052,348)
Net Obligations	(3,624,013)	(1,806,470)
Other Resources		
Imputed Financing from Costs Absorbed by Others (Notes 12 And 13)	4,135,902	3,436,565
Exchange Revenue Not in the Budget	122,205	(491,746)
Net Other Resources Used To Finance Activities	4,258,107	2,944,819
Total Resources Used to Finance Activities	634,094	1,138,349
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	965,201	1,668,796
Resources that Fund Expenses Recognized in Prior Periods	-	(83,348)
Resources that Finance the Acquisition of Assets	(1,019,247)	(1,001,516)
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	(54,046)	583,932
Total Resources Used to Finance the Net Cost of Operations	580,048	1,722,281
Components of the Net Cost of Operations that Will Not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Periods:		
Increase in Exchange Revenue Receivable from the Public	(125,279)	(28,848)
Actuarial FECA Liability Increase (Note 15)	920,601	-
Total Components of Net Cost of Operations that Will Require or Generate Resources in Future Periods	795,322	(28,848)
Components Not Requiring or Generating Resources:		
Depreciation and Amortization	580,235	305,853
Bad Debt Expense, Refunds Receivable from the Public, and Loss on Asset Disposition	(2,521)	63,836
Total Components of Net Cost of Operations that Will Not Require or Generate Resources	577,714	369,689
Total Components of Net Cost of Operations that Will Not Require or Generate Resources in the Current Period	1,373,036	340,841
Net Cost of Operations	$ 1,953,084	$ 2,063,122

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

NOTES TO THE 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 U.S. generally accepted accounting principles (GAAP) and the Statements of Federal Financial Accounting Standards (SFFAS) prescribed by the Federal Accounting Standards Advisory Board, which has been designated the official body for setting standards for the federal government. 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 of funds or payment of cash. Budgetary accounting has also been applied to facilitate compliance with legal constraints and control over the use of funds.

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. Although FCA is not one of the federal agencies mandated to adhere to the CFO Act, 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. In so doing, certain prior year balances have been reclassified to be consistent with the presentation of data reported in FY 2002. The Statement of Custodial Activity contained in OMB Bulletin Number 01-09 is not applicable to FCA and is not included as a part of the financial statements.

On October 18, 2002, the Office of Management and Budget issued a memorandum for Chief Financial Officers and Inspectors General that provided guidance for the format of the FY 2002 Performance and Accountability Reports. Although the *FCA Performance and Accountability Report* is not presented in the exact format as outlined in the memorandum, the required information is provided. The FCA report is presented for readability and has been formatted in a manner that is more conducive to the targeted audiences.

C. Fund Balance with Treasury – FCA maintains a revolving, no year account with the U.S. Treasury through which cash receipts and disbursements are processed. The funds that are available are obtained from assessments, reimbursable activities, and amounts owed by employees and vendors. See Paragraph D below. FCA does not receive appropriated funds.

D. Investments – The Act gives FCA the authority to invest in public debt securities with maturities suitable to FCA's needs. All investments are normally 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.

E. 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) amounts 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, 2002.

F. 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 are capitalized. Items that are less than $5,000 but meet certain bulk purchase criteria are also capitalized. 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.

G. 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.

H. Federal Employee Benefits – Federal employee benefits include benefits earned by employees for pension, post-retirement health insurance, and life insurance. For reporting purposes, each employing federal agency is required to recognize its share of the federal government's cost and imputed financing for these benefits. To meet this requirement, the Office of Personnel Management (OPM) provides to each agency the cost factors used in the calculation of these federal employee benefit expenses.

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

J. Assessments – A substantial portion of FCA's revenues 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.

K. Deferred Revenue – Beginning in fiscal year 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

	2002	2001
Fund Balance with Treasury		
Revolving Fund	$ 229,383	$ 752,291
Total Fund Balance With Treasury	$ 229,383	$ 752,291
Status of Fund Balance with Treasury		
Unobligated Balance		
Available	$ 13,941,462	$ 10,439,654
Unavailable	1,611,366	1,489,161
Obligated Balance	5,077,555	8,793,788
Subtotal – Status of Fund Balance	20,630,383	20,722,603
Funds Invested with Treasury		
Net of Unamortized Discount	(20,401,000)	(19,968,812)
Cash Held Outside Treasury	-	(1,500)
Total Fund Balance With Treasury	$ 229,383	$ 752,291

Note 3. Investments

Intragovernmental Securities

Amounts for 2002 Balance Sheet Reporting

	(1) Amortized Cost	(2) Unamortized (Premium) Discount	(3) Investments Net	(4) Required Market Value Disclosure
Non-Marketable:				
Market-Based	$ 20,885,235	($484,235)	$ 20,401,000	$ 21,081,000
Accrued Interest	95,625	-	-	95,625
Total	$ 20,980,860	($484,235)	$ 20,401,000	$ 21,176,625

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	-	-	15,387
Total	$19,986,030	$ 357	$19,971,000	$ 19,998,262

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 $485,301 and $1,068,465 for fiscal years 2002 and 2001, respectively.

Note 4. Accounts Receivable

	2002	2001
Intragovernmental:		
Reimbursements	$ 63,334	$370,319
Subtotal	63,334	370,319
With the Public:		
Assessments	310,828	105,299
Vendor Overpayments	10,591	50,318
Other	1,294	1,980
Subtotal	322,713	157,597
Total	$386,047	$527,916

Note 5. Cash and Other Monetary Assets

During FY 2001 and prior, the FCA maintained a small imprest fund in the amount of $1,500. On October 30, 2001, in accordance with 31 C.F.R. 208, Management of Federal Agency Disbursements-Final Rule, FCA closed the imprest fund and funds were included as a part of the Fund Balance with Treasury.

Note 6. General Property, Plant, and Equipment

As of September 30, 2002

	Estimated Useful Life	Depreciation Method	Acquisition Value	Accumulated Depreciation	Book Value
ADP Equipment	3 years	Straight Line	$1,986,305	($1,155,361)	$830,944
Software	3 years	Straight Line	72,044	(41,391)	30,653
Total			$2,058,349	($1,196,752)	$861,597

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

Note 7. Accrued Postemployment Compensation:

Intragovernmental – Covered by Budgetary Resources

	Current Liabilities	Non-Current Liabilities	Total
FECA Accrual - 2002	$157,968	$29,889	$187,857
FECA Accrual - 2001	$325,084	$36,000	$361,084

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. FCA elected in FY 1999 to annually reimburse the DOL for the actual benefit payments paid to its employees upon receiving notification of claims incurred. As of September 30, 2002, FCA has an outstanding claim of $187,857 of which $157,968 will be paid for the July 2001 through June 2002 billing.

Note 8. Actuarial Workers Compensation Liability

The DOL estimates future workers compensation (FWC) liability for specified entities preparing statements under the Chief Financial Officers Act and the 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 the DOL provides individual agency estimates on a routine basis.

The FECA Actuarial Liability amounts for FY 2002 and FY 2001 are $2,030,757 and $1,110,156, respectively. The difference between these liabilities is due to the methodology used and the volatility in FCA's payments from year to year. The FCA records the FECA Actuarial Liability as a liability that is "Not Covered by Budgetary Resources."

Note 9. Benefits Due and Payable

Annual Leave, Compensatory Leave, and Credit Hours – FCA's employees earn annual leave (vacation and personal time) per pay period based on years of service. 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. Compensatory Leave is compensation for overtime in the form of time off on an hour-for-hour basis, in lieu of pay. Compensatory Leave is accrued as a liability when earned, and the liability is reduced as the leave is taken. Credit hours represent the approved hours of work that are in excess of an employee's basic work requirement that he or she elects to work so as to vary the length of the workday or workweek. FCA requires that credit hours may only be earned if an employee is working under a Flexible Work Schedule. These hours are not overtime for pay administration purposes. Similar to annual leave and compensatory leave, a liability is established for credit hours earned and the liability is reduced when the credit hours are used. In FY 2002, the liability balances for annual leave, compensatory leave, and credit hours were $2,607,181, $26,299, and $8,477, respectively. This represented a decrease in the FY 2001 liability for annual leave of $4,674 and increases in the compensatory leave and credit hours of $22,886 and $35, respectively.

Leave Bank Program – FCA administers a voluntary leave bank program that allows employees to donate annual and sick 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. The annual leave is accrued as a liability when donated. The amount of the liability is based on each donor's average hourly pay rate times the number of hours contributed. The liability is reduced based on the average hourly pay rate of the recipient times the number of hours used. In FY 2002, the leave bank liability balance is $88,458 as compared with $82,583 in FY 2001.

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.

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 years 2002 and 2001, contributed $750 to each employee's account plus administrative expenses totaling $198,585 and $218,923, respectively. 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 examinations or health screening costs that are not covered by health insurance. The Employee Assistance and Wellness Program expenses were $23,509 and $12,388 for fiscal years 2002 and 2001, respectively.

Child Care Subsidy Program – In an effort to improve recruitment, retention, and attendance and to contribute to overall morale, the FCA has placed in operation the Child Care Subsidy Program. All FCA full-time permanent employees who meet eligibility requirements and whose adjusted gross family income is $60,000 or less per year may participate in the program. FY 2002 is the first year the program was funded within the agency. There was one employee who participated in the program with a cost to the agency of $3,976.

FCA Life Cycle Account – FCA established the FCA Life Cycle Account to provide a work/life environment that assists employees in balancing family and work. This program reimburses employees each fiscal year for certain expenses that have not been reimbursed under another program or insurance policy. All full-time and part-time employees are eligible to participate in the program, and reimbursement of expenses must be incurred by and for the benefit of the employee based on established category types. As established by FCA, each employee may submit only one Life Cycle Account claim per fiscal year, and all expenses claimed must occur within the same fiscal year. The Life Cycle Account was first funded in FY 2002. The maximum reimbursable amount per fiscal year is determined during the annual budget cycle. For FY 2002, each employee was entitled to a reimbursable amount of $400, less tax withholdings, since the Life Cycle Account is considered a supplemental wage. The total expenses FCA incurred for the Life Cycle Account in FY 2002 was $109,099.

Note 10. Gross Cost and Earned Revenue by Budget Functional Classification

Functional Classification	Gross Cost (*)	Earned Revenue	Net Cost
Agriculture			
2002	$40,481,557	$38,528,473	$1,953,084
2001	$38,495,157	$36,432,035	$2,063,122

(*) Intragovernmental costs were in the amounts of $9,848,662 and $8,941,843 for fiscal years 2002 and 2001, respectively; and the intragovernmental revenue amounts were $1,698,680 and 1,945,711, respectively.

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

Farm Credit Administration
Supporting Schedule by Sub-Organization
For the Year Ended September 30, 2002

	Office				
	Examination $	Policy & Analysis $	Secondary Market Oversight $	Support Organization $	Total $
Safety & Soundness					
Intragovernmental	-	-	-	6,822,396	6,822,396
With the Public	15,299,895	466,368	-	5,546,509	21,312,772
Total	15,299,895	466,368	-	12,368,905	28,135,168
Less: Earned Revenue	(14,936,383)	(455,288)	-	(12,075,032)	(27,466,703)
Net Program Cost	363,512	11,080	-	293,873	668,465
Policy & Regulation					
Intragovernmental	-	-	-	2,208,359	2,208,359
With the Public	79,021	3,143,876	83	3,870,708	7,093,688
Total	79,021	3,143,876	83	6,079,067	9,302,047
Less: Earned Revenue	(77,154)	(3,069,603)	(81)	(5,935,451)	(9,082,289)
Net Program Cost	1,867	74,273	2	143,616	219,758
Other Activity					
Intragovernmental	-	-	-	817,977	817,977
With the Public	1,253,838	117,388	337,984	517,155	2,226,365
Total	1,253,838	117,388	337,984	1,335,132	3,044,342
Less: Earned Revenue	(815,266)	(76,327)	(219,763)	(868,125)	(1,979,481)
Net Program Cost	438,572	41,061	118,221	467,007	1,064,861
Cost Not Assigned to Programs	-	-	-	-	-
Less: Earned Revenues not Attributed to Programs	-	-	-	-	-
Net Cost of Operations	803,951	126,414	118,223	904,496	1,953,084

Note 11. Sub-Organization Program Costs/Program Costs by Segment (cont'd.)

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	-	-	-	6,067,962	6,067,962
With the Public	13,726,022	639,953	4,275	3,637,211	18,007,461
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	-	-	-	2,386,159	2,386,159
With the Public	116,824	5,047,649	355	4,967,132	10,131,960
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
Other Activity					
Intragovernmental	-	-	-	487,722	487,722
With the Public	597,811	148,569	318,682	348,831	1,413,893
Total	597,811	148,569	318,682	836,553	1,901,615
Less: Earned Revenue	(705,487)	-	(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	-	-	-	-	-
Less: Earned Revenues not Attributed to Programs	-	-	-	(9,228)	(9,228)
Net Cost of Operations	602,068	440,181	(509,308)	1,530,180	2,063,122

Note 12. Federal Employee Benefits

	2002	2001
Funded Pension Cost	$2,253,691	$2,267,661
Imputed Pension Cost	962,587	798,018
Other Imputed Retirement Benefits	871,323	761,574
Total	$4,087,601	$3,827,253

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 13. Rent

	2002	2001
Leased Field Offices	$ 762,701	$ 752,770
FCA Headquarters	1,539,291	1,124,203
Total	$2,301,992	$1,876,973

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, 2001.

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 14. Budgetary Resources

The Total Budgetary Resources reported in these financial statements is $47,925,346. The budget authority for the FCA, in the Budget of the United States Government, is $53,000,000. The difference is $5,074,654. This difference includes $2 million that was included in the U.S. Budget Report for FCA's actuarial liability, but is reported in the financial statements as "Not Covered by Budgetary Resources." The budget also included an estimate for investment interest collections of $1 million, which did not materialize. In addition, there was a $2.1 million refund to the System institutions that was reflected in the financial statements, but was not included in the budget. These items represent a net difference between the financial statements and the budget of approximately $5.1 million. The remaining difference is due to rounding.

Note 15. Relationship Between Liabilities Not Covered by Budgetary Resources and the Change in Components Requiring or Generating Resources in Future Periods

Operating as a revolving fund, the FCA funds its liabilities, except for the FECA actuarial liability. The FECA actuarial liability is reported on the balance sheet as unfunded, not covered by budgetary resources. In FY 2002, there was an increase in the actuarial liability amount of $920,601. This amount is also reported on the Statement of Financing as a component of net cost of operations that will require budgetary resources in future periods.

Note 16. 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 $120,031 and $180,673 for the fiscal years ended September 30, 2002 and 2001, respectively.

The fiscal years 2002 and 2001 reimbursable from FCSIC include intragovernmental accounts receivable of $7,501 and $39,322, respectively.

The memorandum of understanding between FCA and FCSIC to provide accounting services ended in FY 2002; however, other administrative services continued.

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 13). FCSBA also leases telecommunications equipment to FCA under a reimbursable operating lease that is renewable annually. Telecommunication expenses were $357,091 and $295,928 for fiscal years 2002 and 2001, respectively. Also, in FY 2002, other contractual services were incurred at a cost of $46,972.

The FCSBA is assessed for each fiscal year in which FCA examines it. The assessment for FY 2002 was $7,777; and the amount for FY 2001 was $11,401. 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, 2002

Agency	Fund Balance with Treasury	Investments	Accounts Receivable	Prepayments
U.S. Department of Treasury	$ 229,383	$ 20,980,860	$ -	$ -
Small Business Administration	-	-	50,313	-
FCS Insurance Corporation	-	-	7,501	-
Library of Congress	-	-	-	7,974
U.S. Department of Labor	-	-	5,520	46,319
Total	$ 229,383	$ 20,980,860	$ 63,334	$ 54,293

As of September 30, 2001

Agency	Fund Balance with Treasury	Investments	Accounts Receivable	Prepayments
U.S. Department of Treasury	$ 752,291	$ 19,986,030	$ -	$ -
U.S. Department of Agriculture	-	-	172,298	-
Small Business Administration	-	-	157,862	-
FCS 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

Required Supplemental Information (cont'd.)

Intragovernmental Liabilities

As of September 30, 2002

Agency	Accounts Payable	Other Liabilities
U.S. Department of Labor	-	$ 187,857
U.S. Department of Interior	$ 181,215	-
Office of Personnel Management	-	79,840
Social Security Administration	-	28,825
U.S. Department of Agriculture	-	20,442
Board of Governors of the Federal Reserve	14,400	-
Internal Revenue Service	3,036	-
Federal Deposit Insurance Corporation	2,700	-
U.S. Treasury – Franchise Business Activity	304	-
Total	$ 201,655	$ 316,964

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	189,090
Social Security Administration	-	61,220
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	$ 611,394

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 residents 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, 2002, 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 the availability of 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, called 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.

FCA Employee Benefits . . .

The Farm Credit Administration helps employees balance the many different parts of their lives—work, family, and community—with a variety of benefits and family friendly programs. The unique combination of competitive salaries and federal government and agency benefits help employees build a rewarding career while enjoying a flexible and well-balanced worklife. The 276 dedicated men and women who work at our offices across the country and are an integral part of this public-spirited government agency enjoy the following benefits.

Alternative Work Schedules
- Alternative work schedules that allow full-time employees and their managers to set work schedules that help them balance work and family needs.
- Flexible and compressed work schedules that let employees work nine or 10 hours per day so they can enjoy "flex days off."
- A flexible time band that allows employees, with their supervisors' approval, to choose the start and end times for their workdays.
- Flexitour, which lets staff members change their workday start times with their supervisors' approval.
- With a supervisor's approval, an employee may earn credit hours, which can be used when accommodating work and family responsibilities.
- Employees can earn compensatory time, with supervisors' approval, for overtime.

Flexible Work Arrangements
- A Flexiplace Program that allows employees to work from home, with supervisory approval. Some staff members telecommute to avoid long commutes, while others work from home during bad weather.
- Part-time job opportunities are available.

Family-Friendly Leave Policies and Programs
- The Office of Personnel Management (OPM) annual leave policy, which includes 10 paid federal holidays each year.
- The OPM sick leave policy. Full-time employees earn four hours of sick leave every two weeks.
- The FCA Leave Bank lets staff donate annual and/or sick leave to a general pool for use by other employees in case of family or personal medical emergencies.
- The Federal Leave Transfer Program lets staff donate annual and/or sick leave to other federal government employees for medical emergencies.

Health, Wellness, and Fitness Programs and Activities
- A wide range of federal government health insurance plans. FCA pays part of the insurance premium.
- Reimbursement of up to $150 for annual physical examinations and preventive tests.
- A fitness center in the McLean, Virginia, headquarters.
- Health and fitness programs to encourage healthier living.

. . . Striking a Balance

- An Employee Assistance Program for short-term crisis counseling and guidance for employees and their families.
- On-site defibrillators.
- Subsidized flu shots.

Career and Self-Development Opportunities
- Individual Development Plans created by employees and supervisors to plan career goals and maximize training opportunities.
- Educational seminars and information sharing that are useful to employees and their families.

Awards and Recognition
- Cash and time-off incentive awards for exceptional work.

Transportation and Parking
- Monthly transit subsidies for employees who use public transportation.
- Free parking provided to all employees.

Families with Children
- A childcare subsidy of up to 70 percent, depending on family income.
- A pre-tax Flexible Spending Account to help employees save money for health care or childcare. In FY 2002, FCA contributed $750 to each employee's account.
- A $400 Life Cycle Account to help employees pay for health and fitness equipment and programs.

Miscellaneous Work/Life Initiatives
- Business casual dress at the office.
- The federal government's group life insurance program.
- The federal government's Thrift Savings Plan, a tax-deferred savings and investment program to help build retirement savings.
- An optional 401(k) plan to enhance retirement savings.
- Free long-term disability insurance.
- Optional Federal Long-Term Care Insurance Program.
- Federal government retirement programs that provide annuities and death benefits.

Employees of the Farm Credit Administration

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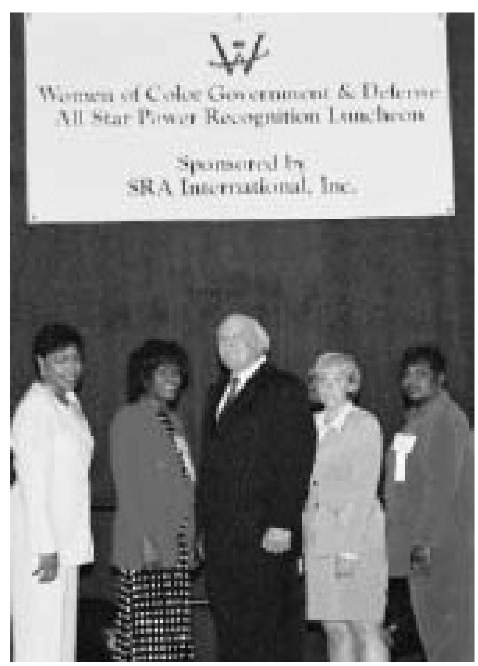

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The *Farm Credit Administration Performance and Accountability Report Fiscal Year 2002* is now available on FCA's Web site at www.fca.gov. While supplies last, printed copies of this publication and earlier editions may be obtained without charge from:

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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:

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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.

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