FARM CREDIT ADMINISTRATION

1997 Annual Report

Contents

Chairman's Message

The Farm Credit Administration (FCA or Agency) Board is once again at full strength. On May 27, 1997, Board Member Doyle Cook and I welcomed Ann Jorgensen to the FCA Board, which had not had a full three-member complement since March 31, 1995. Ms. Jorgensen is a producer from Iowa with an active third generation family farm and a highly respected leader in agriculture and agribusiness. She is a valuable addition.

We continued our commitment to effectiveness and cost efficiency this past year. Much of the Five-Year Staffing and Structure Plan is now in place. We reduced Agency staffing levels from 332 to 303, established a new organizational structure and leadership team, reorganized several offices, reduced a level of management by eliminating the regional offices within the Office of Examination (OE), and closed two OE field offices. Our goal has been to effect these improvements and efficiencies without sacrificing program effectiveness.

We also moved aggressively in implementing a client/server computer architecture to improve Agency operations. This technology allows us to streamline the examination process and more quickly share information and data among all headquarters and field staff. The FCA Board is soon to approve a plan that we believe will ensure that any potential technology-related Year 2000 issues for the Agency have been addressed.

Recently, we were pleased when a lawsuit challenging the authority of the FCA Board to revise the 25-year-old rules under which Farm Credit institutions make loans to eligible borrowers was dismissed by the United States District Court for the District of Columbia. The lawsuit was filed by the Independent Bankers Association of America and the American Bankers Association on April 9, 1997.

All along, we remained confident that the customer eligibility rule complied with the Farm Credit Act of 1971, in all respects, and that the Court would hold that the FCA Board acted well within its statutory authority. This certainly proved the case. The Court even noted that "The agency adopted its new regulations in a thoughtful, reasoned manner, taking care to consider the concerns of the affected parties in the notice and comment period." We do not know if the bankers will appeal the decision.

The customer rule, coupled with new capital standards we established for Farm Credit System institutions, may be our most significant accomplishment of the decade. Together, they ensure strong financial standards and a continuing, competitive source of credit for agriculture and rural America in good times and bad. This is especially important as farmers, ranchers, and cooperatives compete in a more global economy.

Another major accomplishment this year was a congressional review of our Strategic Plan and development of our first Annual Performance Plan in accordance with the Government Performance and Results Act of 1993. Our Performance Plan reflects how Agency employees will implement initiatives of our Strategic Plan. It includes specific performance elements that communicate clearly what we will do and how we will measure our performance. We are pleased to report that the congressional staff that asked to review our Strategic Plan was complimentary of our efforts.

The principles of ensuring sound financial institutions to serve agriculture, improving customer service, effecting clear and candid communication, and producing quality products are at the heart of my operating philosophy for the Agency. I do hope these principles come through loud and clear as we go about our important job of regulating the Farm Credit System.

Marsha Pyle Martin
Chairman
December 30, 1997

Farm Credit Administration Board

Photo Not Available

Marsha Pyle Martin, Chairman
Doyle L. Cook, Board Member
Ann Jorgensen, Board Member

Overview of Organizations

Farm Credit Administration

The Farm Credit Administration (FCA or Agency), an independent agency in the executive branch of the U.S. Government, is responsible for regulating and examining the banks, associations, and related entities that constitute the Farm Credit System (FCS or System). Initially created by an Executive order of President Franklin D. Roosevelt in 1933, the Agency now derives its powers and authorities from the Farm Credit Act of 1971, as amended (Act). The FCA issues regulations to implement the Act and examines FCS institutions for compliance with applicable statutes, regulations, and safe and sound banking practices. If an institution violates statutes or regulations or operates in an unsafe or unsound manner, the Agency has several enforcement options to bring about corrective action. In addition, the FCA annually examines the National Consumer Cooperative Bank (NCB) and its affiliate, the NCB Development Corporation, and presents the reports of examination to the U.S. Senate Committee on Banking, Housing, and Urban Affairs and the U.S. House of Representatives Committee on Banking and Financial Services.

The Agency has its headquarters in McLean, Virginia. It has field offices at its headquarters and in Bloomington, Minnesota; Dallas, Texas; Denver, Colorado; and Sacramento, California.[1]

Farm Credit Administration Board

FCA policymaking is vested in a full-time, three-person Board appointed by the President with the advice and consent of the U.S. Senate. FCA Board members serve a 6-year term and may not be reappointed after serving a full term or more than 3 years of a previous member's term. The President designates one of the members as Chairman of the Board. The Chairman also serves as the Agency's chief executive officer.

Marsha Pyle Martin was appointed to the FCA Board and designated Chairman by President Clinton on October 17, 1994; her term expires October 13, 2000. Ms. Martin also serves as chief executive officer of the Agency. She brings to her position more than 30 years of experience in agriculture and agricultural finance. A Texas native, she joined the Federal Intermediate Credit Bank (FICB) of Texas in 1970 and in 1979 was the first woman appointed to a senior officer position in the System. During her career with the FICB of Texas and the Farm Credit Bank (FCB) of Texas, she gained broad management experience, providing leadership and direction for the bank's corporate relations, legal, operations and supervision, management information, human resources, marketing, and public and legislative affairs departments. She has held leadership positions with various agricultural councils and advisory committees in Texas, including the Texas Agricultural Loan Mediation Program Advisory Board, the Texas Department of Commerce Credit Advisory Committee, the Texas Agricultural Lifetime Leadership Board of Directors, and the Texas Agricultural Cooperative Council. In 1990, she received the Cooperative Communicators Association's highest honor, the H.E. Klinefelter Award, in recognition of her distinguished contributions to cooperative communications. In 1995, she was honored by the Board of Directors of the FCB of Texas as the individual who had made the greatest contribution to agriculture and farm credit in Texas and was named to the Academy of Honor in Agriculture. In 1996, she was presented the Distinguished Alumni Award by Texas Woman's University. She holds a B.A. from Texas Woman's University and an M.S. from Texas A&M University.

1. The regional offices in Denver, Colorado, and McLean, Virginia, and the field offices in Marietta, Georgia, and St. Louis, Missouri, were closed as of March 31 and June 30, 1997, respectively.

Doyle L. Cook was appointed to the FCA Board by President Clinton on October 5, 1994, for a term that expires May 21, 1998. Mr. Cook also serves as chairman of the Farm Credit System Insurance Corporation's (FCSIC's) Board of Directors. He brings to this position more than 30 years of experience in agricultural lending, 19 of which were with various FCS institutions. Before his appointment to the FCA Board, Mr. Cook served as president and chief executive officer of the FCB of Spokane, an active participant on various committees of FCS banks, a director of the Federal Agricultural Mortgage Corporation (Farmer Mac), and a member of the Chicago Mercantile Exchange Lender Advisory Committee. Previously, he served as president and chief executive officer of the Farm Credit Services of Mid-America, Agricultural Credit Association (ACA); senior vice president for credit for the FICB of Texas; and senior vice president of the FICB of Louisville. He began his career with Ralston Purina, where he worked in credit, marketing, finance, and general management for 13 years before joining the FCS. Mr. Cook, a native of Star City, Arkansas, holds a B.S. in agricultural business and an M.S. in agricultural economics from the University of Arkansas.

Ann Jorgensen was appointed to the FCA Board by President Clinton on May 27, 1997, for a term that expires May 21, 2002. She brings to her position extensive experience in production agriculture and accounting. In 1963, she started farming in partnership with her husband. Their farming operation now includes a cropping operation, Jorg-Anna Farms, and a hog operation, Timberland Hogs Ltd. She also worked for 10 years as a tax accountant and for 7 years as a licensed commodity broker. In 1981, she started Farm Home Offices, a mail-order catalog company that sells farm management products designed to help farmers improve their financial and production management systems. She served on a number of governing boards for the State of Iowa, including, for 6 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. She is a co-author of a producer's guide entitled *The Farmer's Guide to Total Resource Management* and is the author of a book, *Put Paperwork in Its Place.* She was honored as the Outstanding Young Woman for the State of Iowa in 1976 and was inducted into the Iowa Volunteer Hall of Fame in 1989. She 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. A native of Iowa, she holds a B.A. from the University of Iowa.

Office Functions

The **FCA Board** is responsible for Agency policy, promulgation of regulations to implement the Farm Credit Act, and enforcement activities. It 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** processes all matters that go to FCA Board members, ensures compliance with public disclosure laws, and manages the day-to-day operations of the Office of the Board.

The **Office of the Chief Executive Officer** operates in accordance with the policies established by the FCA Board. The 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 Congressional and Public Affairs** coordinates and disseminates Agency information to Congress, FCS institutions, employees, Federal agencies, the media, and others. It also develops and monitors legislation pertinent to the FCA and the FCS, serves as the Agency's congressional liaison, and prepares testimony for the chairman and other Agency officials.

The **Office of Examination** provides regulation and oversight of FCS institutions through examination, supervisory programs, and regulatory standards that promote safe and sound operations and ensure compliance with applicable laws and regulations; and directs a program of examination policy formulation.

The **Office of General Counsel** provides the FCA Board and staff with legal services. It supports the Agency in its supervision and examination of FCS institutions, development and promulgation of regulations, review of legislative proposals, defense of civil litigation, enforcement of applicable laws and regulations, implementation of conservatorships and receiverships, and oversight of Farmer Mac. It also fulfills the Agency's responsibilities under the Freedom of Information Act and the Privacy Act and provides guidance on general corporate, personnel, ethics, and administrative matters.

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

The **Office of Policy Development and Risk Control** has primary responsibility for developing regulations and policy positions to implement applicable statutes and promote the safety and soundness of the FCS. It also processes regulatory approvals, manages the Agency's chartering and enforcement activities, and provides economic and financial analyses to identify risks facing the FCS.

The **Office of Resources Management** provides Agency financial and administrative management services primarily in accounting, budgeting, cash management and investments, strategic planning[2] and performance measurement, and information and human resources. These areas include such administrative services as computer applications development and systems administration, contracting and procurement, payroll, training, telecommunications, personnel security, property management, space allocation, publications, supplies, and mail and internal communications.

The **Office of Secondary Market Oversight** uses examination, general rulemaking, and enforcement authority to provide for and oversee the safe and sound performance of Farmer Mac.

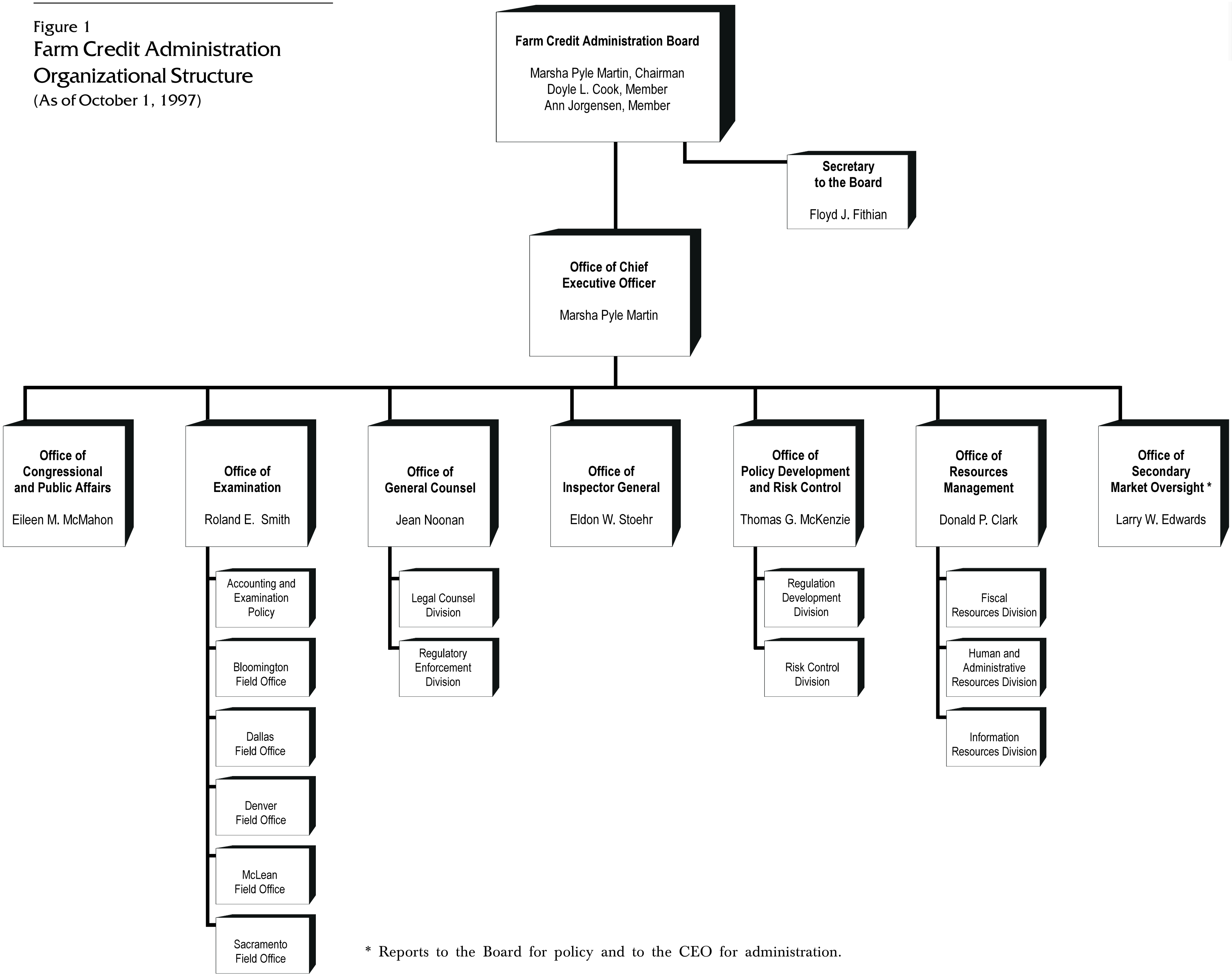
Figure 1 on page 6 depicts FCA's organizational structure as of October 1, 1997.

Officials[3]

Marsha Pyle Martin	Chief Executive Officer
Floyd J. Fithian	Secretary to the Board
Eileen M. McMahon[4]	Director, Office of Congressional and Public Affairs
Roland E. Smith	Chief Examiner and Director, Office of Examination
Jean Noonan	General Counsel
Eldon W. Stoehr	Inspector General
Thomas G. McKenzie	Director, Office of Policy Development and Risk Control
Donald P. Clark[5]	Director, Office of Resources Management
Larry W. Edwards	Director, Office of Secondary Market Oversight

2. Until September 30, 1997, the Office of Policy Development and Risk Control was responsible for Agency strategic planning.
3. David C. Lavoie served as the Chief Operating Officer until his retirement on March 31, 1997; no successor has been named.
4. Eileen M. McMahon was appointed Director, Office of Congressional and Public Affairs, on December 2, 1996. Nancy E. Lynch served as Acting Director from August 19 until December 2, 1996.
5. Donald P. Clark was named Director, Office of Resources Management, on April 1, 1997. Michael L. Young served as Acting Director, Office of Resources Management, until his retirement on March 31, 1997.

Figure 1
Farm Credit Administration Organizational Structure
(As of October 1, 1997)



* Reports to the Board for policy and to the CEO for administration.

Farm Credit System

The FCS is a network of borrower-owned cooperative financial institutions and related service organizations that serves all 50 States and the Commonwealth of Puerto Rico. These institutions specialize in providing credit and related services to farmers, ranchers, producers or harvesters of aquatic products, and farmer-owned cooperatives. Loans may be made to finance certain processing and marketing activities of these borrowers. Loans may also be made to rural homeowners (for housing); certain farm-related businesses; and agricultural, aquatic, and public utility cooperatives.

On September 30, 1997, there were 216 System banks and associations, consisting of the following:

- Six FCBs, which provide loan funds to 64 Production Credit Associations (PCAs), 56 ACAs, and 31 Federal Land Credit Associations (FLCAs) and make direct long-term real estate loans through 53 Federal Land Bank Associations (FLBAs). PCAs make short- and intermediate-term loans; ACAs make short-, intermediate-, and long-term loans; FLCAs make long-term loans; and FLBAs act as lending agents for the banks.

- One Bank for Cooperatives (BC), which makes loans to agricultural, aquatic, and public utility cooperatives, and other persons or organizations owned by or having transactions with such cooperatives.

- One Agricultural Credit Bank (ACB), which has the combined authorities of an FCB, providing loan funds to four ACAs, and a BC. In addition, both the BC and the ACB are authorized to finance U.S. agricultural exports and provide international banking services for farmer-owned cooperatives.

The following FCS entities are also examined and regulated by the FCA:

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

- The FCS Financial Assistance Corporation was chartered in 1988 to provide needed capital to the System through the purchase of preferred stock issued by System institutions that received financial assistance authorized by the FCS Assistance Board.

- The Federal Agricultural Mortgage Corporation guarantees the timely payment of principal and interest on securities representing interests in, or obligations backed by, pools of agricultural real estate loans.

Service corporations organized under Section 4.25 of the Act include the following:

- 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 provides equipment leasing services to eligible borrowers, including agricultural producers, cooperatives, and rural utilities.

- Farm Credit Financial Partners, Inc., provides support services to the associations affiliated with CoBank, ACB.

- AgCo Services Corporation is chartered to provide management information systems and electronic data processing services to CoBank, ACB.

- The FCS Building Association acquires, manages, and maintains facilities to house the FCA's headquarters and field offices. The FCSBA was formed in 1981 and is owned by the FCS banks. However, the FCA Board oversees the FCSBA's activities.

Farm Credit System Insurance Corporation

The FCSIC was established by the Agricultural Credit Act of 1987 to ensure the timely payment of principal and interest on insured notes, bonds, and other obligations issued on behalf of FCS banks and to act as conservator or receiver of FCS institutions. By ensuring the repayment of FCS securities to investors, the FCSIC helps to maintain a dependable source of funds for farmers, ranchers, and other FCS borrowers. FCA Board members serve ex officio as the Board of Directors for the FCSIC; however, the FCA Board chairman may not serve as the chairman of the FCSIC Board.

Farm Credit Administration Performance Report

Highlights of Operations

A key Farm Credit Administration objective in recent years has been to improve the strategic planning and implementation process to help the FCA better meet its congressional mandate and the requirements of the Government Performance and Results Act of 1993 (Results Act). In fiscal year (FY) 1997, the FCA Board and senior management performed a comprehensive review of the Agency's Five-Year Strategic Plan and received input through its required congressional consultation. As a result, the Agency's mission statement was modified to clarify the focus on the Agency's regulatory role and legislative mandate. In addition, the goals in the Strategic Plan were revised to reflect the Agency's accomplishments in the past year as well as new developments in the operating environment.

The Agency's revised mission statement is as follows:

> The Farm Credit Administration will promote a safe and sound, competitive Farm Credit System by creating an environment that enables it to serve rural America as a dependable source of credit and other financial services within the authorities established by Congress.

The FCA Board vision for the Agency is that the FCA will continue to be a recognized leader in effective and efficient financial regulation. In keeping with this vision and to help guide operations, the Board adopted the following goals for the Agency to pursue during FY 1997–2002:

1. Minimize risk to the System's customers/shareholders, investors, and the Farm Credit Insurance Fund.

2. Implement regulations and policies that ensure a competitive and dependable system of credit and financial services for agriculture and rural America.

3. Enhance FCA's effectiveness, efficiency, and external relationships.

In addition to these goals, the Strategic Plan contains a number of strategies and actions designed to ensure that the goals are met.

During FY 1997, the FCA Board was successful in reducing Agency costs, reducing regulatory burden, and overseeing the transition to a client/server computer architecture and the creation of innovative examination and supervisory programs. While some of these initiatives were rooted in legislative developments, they also reflect the Agency's commitment to improve efficiency, strengthen communication with its constituencies, and become more customer focused. Meeting the needs of customers without compromising the safety and soundness of the FCS continues to be our central focus as a regulator of financial institutions.

Reduction of regulatory burden continued during the year. The FCA eliminated, or proposed for elimination, several Agency prior-approval requirements. Regulatory burden was also reduced through the deletion of several obsolete regulatory provisions identified through public comment or internal Agency review. Also, the Agency incorporated the comments it received through an Advance Notice of Proposed Rulemaking while developing a proposed regulation for Other Financing Institutions.

In FY 1997, the FCA neared completion of its implementation of a client/server computer architecture as the foundation for applying technology to improve Agency operations. This technology permits easier access to and use of information needed to accomplish the FCA's mission. It will enable the FCA to streamline the examination process, enhance efficiency and effectiveness, and share information among all headquarters and field staff. In implementing the client/server environment, the FCA has also ensured that any potential Year 2000 issues (see Glossary, page 42) have been addressed.

In a continuing effort to improve communication, the FCA Board sponsored meetings with board chairmen and presidents of FCS institutions. These meetings provided an opportunity for two-way communication on topics ranging from the Agency's internal operations to current regulatory issues. FCA Board members and executives frequently visit FCS institutions, farmer and agricultural organizations, and Agency field offices. Furthermore, Agency officials worked closely with Congress by providing testimony and staff briefings on several issues, particularly on the availability of credit in rural America. FCA responded to requests for information about its programs and operations and conducted 63 reviews based on borrowers' inquiries concerning possible violations of their borrower rights.

This year, the Agency revised and reissued one of its widely utilized publications, *The Director's Role: Farm Credit System Institutions*. This publication is used by many banks and associations as the cornerstone of their director training programs. The Agency also published a new pamphlet, *Where Have All the Customers Gone? Dispelling the Myths After 25 Years of Changes in Agricultural Credit Markets*. The pamphlet pinpoints the three most important trends currently being experienced in U.S. agricultural credit markets–the declining number of farms, the drop in FCS market share over the 1985–1995 period, and the changes in the structure of eligible borrowing units over the past three decades.

The Agency's financial statements for the fiscal year ended September 30, 1997, received an unqualified opinion. The auditors reported no material weaknesses in their report on the internal control structure of the Agency, and no instances of noncompliance with laws and regulations.

The Agency's financial accomplishments in FY 1997 include the following:

- Applied $3.4 million of amounts due to FCS institutions to reduce their FY 1998 assessments. The $3.4 million included a portion of prior years' assessments and the Agency's earned interest and miscellaneous income.
- Continued to exercise effective controls over spending. The Agency's overall obligations were $2.5 million less than budgeted.
- Acquired a new financial management system and selected a product that will permit the Agency to implement financial controls in response to previous audit recommendations.

Performance Measures

In FY 1997, the Agency produced its first Annual Performance Plan (APP), covering FY 1999, in accordance with the Results Act. The APP for FY 1999 lists the performance measures and goals for FCA's operations. A list of the performance measures, which is published in the *FCA Strategic Plan for FY 1997–2002*, is available on FCA's Web page at www.fca.gov or can 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.

Many of the performance measures and goals, which link to the Agency's Strategic Goals, Strategies, and Actions, assess the Agency's ultimate effectiveness in ensuring the safe and sound operation of the FCS.

The development of the performance measures and goals was an inclusive effort by the Agency, involving everyone from the FCA Board members to front-line employees. The Agency has developed an integrated performance measurement system that measures and evaluates not only the results obtained by the Agency, but the individual staff contributions as well. To complete the performance measurement system, the Agency's performance measures will be linked to the performance standards of every employee.

In FY 1998, the Agency will test the validity of the performance measures and goals in the APP. At year-end, a reassessment will be made to determine whether any adjustments need to be made to the APP. Improvements will also be made to the Agency's information systems as necessary to ensure that performance measures data are collected in a timely, efficient, and accurate manner.

Regulations

The FCA has statutory and regulatory authority to establish policy and interpret the Farm Credit Act. As such, the Agency promulgates policy statements and regulations to ensure that the FCS complies with the law and operates in a safe and sound manner. Furthermore, as the independent regulator of the System, the FCA is responsible for protecting the public's interests. Therefore, the FCA Board strives to adopt sound and constructive policies and regulations, use a proactive and preventive approach, and reflect the changing needs of agriculture. The FCA Board's objective is to promulgate regulations that achieve safety and soundness goals while minimizing regulatory burden on the institutions it regulates. FY 1997 was an active regulatory year for the Agency. Following are brief summaries of the final and proposed rules adopted by the FCA Board.

Final Regulations

Civil Money Penalty Inflation Adjustment – As required by the Debt Collection Improvement Act of 1996 (DCIA), the FCA Board adopted a final rule amending 12 CFR Part 622 that adjusts each civil money penalty (CMP) under its jurisdiction by the rate of inflation using the formula prescribed by DCIA. This statute required all Federal agencies to adjust each CMP by the rate of inflation and issue implementing regulations within 180 days after enactment of DCIA and at least once every 4 years thereafter. The increases apply only to violations that occur after the effective date of the regulation. (Adopted October 15, 1996; published October 22, 1996 (61 FR 54728); effective October 23, 1996)

Book-Entry Farm Credit Securities – On December 20, 1996, interim regulations were published that completely revise the procedures governing the issuance, maintenance, and transfer of Farm Credit securities on the Book-entry System (61 FR 67188). The FCA's interim rulemaking followed the action of the Department of Treasury (Treasury), which revised its book-entry regulations to eliminate outdated legal concepts and incorporate significant changes in commercial and property law affecting the holding of securities through financial intermediaries. At the request of Treasury, and in coordination with other regulators of Government-sponsored entities, the FCA's interim rule was made effective on January 1, 1997, the date on which Treasury's new book-entry regulations became effective. This coordinated action was designed to avoid market uncertainty and help ensure a consistent regulatory approach for all users of the Book-entry System, including System institutions. The interim rulemaking provided for a post–effective date comment period. Thereafter, the FCA Board adopted the interim rule as final with minor technical changes. The action also simultaneously finalized conforming amendments in the book-entry regulations governing securities of the Farm Credit System Financial Assistance Corporation and the Federal Agricultural Mortgage Corporation. (Adopted September 10, 1997; published October 14, 1997 (62 FR 53227); effective date pending)

Regulation Review/Deletions – As part of continuing efforts to maintain regulations that reflect current practices, the FCA Board adopted as final without change an interim rule updating 12 CFR Parts 600, 603, 611, 614, 615, 618, and 619. The final rule eliminated unnecessary, outdated, duplicative, or burdensome regulatory requirements. In addition, the rule replaced outdated regulatory language with more current terminology and clarified the intended meaning of certain regulatory provisions. (Adopted March 24, 1997; published April 14, 1997 (62 FR 18037); retroactively effective March 4, 1997)

Capital Adequacy and Customer Eligibility[6] – With the adoption of final amendments to the capital adequacy and customer eligibility rules, the FCA Board implemented recommendations stemming from the 1988 International Basle Accord that called for minimum levels of high-quality, risk-based capital and updated several customer eligibility rules that were either antiquated or unnecessary to implement the Farm Credit Act. The rule added core surplus and total surplus standards for banks, associations, and the Farm Credit Leasing Services Corporation; a net collateral ratio for banks; and procedures for setting higher capital standards for individual institutions and for issuing capital directives, when warranted. The rule incorporated amendments to the Farm Credit Act that govern the eligibility rules for lending to farmer cooperatives and provide Farm Credit banks and associations with new authorities to participate with non-System lenders in loans to similar entities. In addition, the revisions eliminated restrictions in the former eligibility regulations that were not required by the Farm Credit Act. (Adopted January 9, 1997; published January 30, 1997 (62 FR 4429); effective March 11, 1997)

Quarterly Reports – The final rule pertaining to financial reports to shareholders implements a provision of the Farm Credit System Reform Act of 1996 that superseded an FCA regulation. Most important, the new regulations no longer require FCS institutions to disseminate quarterly reports to shareholders. Now FCS institutions are required to make quarterly reports available to shareholders only on request. The amendments changed several other sections of 12 CFR Parts 620 and 630 that govern the preparation, filing, and distribution of System bank and association reports to shareholders and investors. The rule imposes a new notice requirement designed to improve shareholder access to timely information and disclosure regarding adverse events affecting shareholders' institutions. Under the new regulations, FCS institutions must prepare and distribute a notice to shareholders when their permanent capital falls below the regulatory minimum standard. In addition, to facilitate the presentation of financial statements by FCS institutions in a manner that conforms with generally accepted accounting principles, the rule removes the requirement that banks must present their financial statements on a combined basis with their related associations. (Adopted March 20, 1997; published March 31, 1997 (62 FR 15089); effective May 6, 1997)

Criminal Referral – The FCA Board adopted a final rule amending 12 CFR Part 617, which governs the referral of known or suspected criminal violations, to promote consistency, efficiencies, and timeliness by System institutions in reporting, investigating, and aiding in the prosecution of known or suspected criminal activities. The final rule requires System institutions to notify law enforcement agencies of known or suspected criminal violations that meet certain reporting thresholds. Generally, a criminal violation must be reported under this part if there is a reasonable basis to conclude that there was an intent to "defraud" a System institution and if the amount of the actual or potential loss meets the reporting thresholds. The final rule also mandates the continued use of the FCA Criminal Referral Form for making a criminal referral. (Adopted April 24, 1997; published May 6, 1997 (62 FR 24562); effective June 13, 1997)

Farmer Mac Receiver/Conservator – A new subpart was added to 12 CFR Part 650 to govern a receivership or conservatorship of the Federal Agricultural Mortgage Corporation. The new subpart implements the receivership/conservatorship authorities granted to the FCA by the Farm Credit System Reform Act of 1996, Pub. L. 104–105 (February 10, 1996) and by previous law. (Adopted July 24, 1997; published August 15, 1997 (62 FR 43633); effective October 1, 1997)

Releasing Information – The FCA Board adopted regulatory amendments governing the release of information to make applicable FCA regulations conform to the requirements of the Freedom of Information Act (FOIA), as amended by the Electronic Freedom of Information Act Amendments of 1996. In addition, the regulations specify the address of the FCA official who receives FOIA requests for records. (Adopted July 24, 1997; published August 1, 1997 (62 FR 41253); effective October 2, 1997)

Cumulative Voting – The final rule on cumulative voting eases the previous requirement of unanimous shareholder consent to eliminate cumulative voting while maintaining significant protection for minority interests. Specifically, the rule amended 12 CFR Part 615 to provide

6. Amendments were proposed to the capital provisions of FCA's regulations on July 25, 1995 (60 FR 38521) and to the customer eligibility provisions on September 11, 1995 (60 FR 47103). In response to comments received, the two proposals were combined and published as proposed amendments to the capital adequacy and customer eligibility regulations for FCS institutions on August 13, 1996 (reproposed rule). See 61 FR 42092.

that a Farm Credit Bank may eliminate cumulative voting in director elections with the consent of 75 percent of the FCB's association shareholders. (Adopted September 11, 1997; published September 24, 1997 (62 FR 49907); effective October 30, 1997)

Loan Underwriting – The FCA Board refocused its regulations on loan underwriting in an effort to streamline the regulations and set clear minimum regulatory standards where appropriate, as well as to respond to comments received from its initiative to reduce regulatory burden. This action eliminated unnecessary regulations but mandated that each System institution adopt loan underwriting policies and standards, and establish certain prudent credit administration practices. (Adopted September 18, 1997; published September 30, 1997 (62 FR 51007); effective November 5, 1997)

Proposed Regulations

General Financing Agreement (GFA) – As part of the continuing effort to eliminate prior approvals of routine business activities, the FCA Board proposed changes to FCA regulations governing the funding relationship between an FCB or Agricultural Credit Bank and a direct lender association or Other Financing Institution (OFI). The proposed changes would repeal the existing requirement for FCA prior approval of the GFA between an FCB or ACB and a direct lender association or OFI and eliminate a specific regulatory direct loan limitation. In addition to the amendments to 12 CFR Part 614, the proposed rule would amend 12 CFR Part 627 to authorize the voluntary liquidation of FCS institutions by means of an FCA-approved liquidation plan. (Adopted February 20, 1997; published March 24, 1997 (62 FR 13842))

Other Financing Institutions – A rule on OFIs was proposed that would provide non-System OFIs with greater access to financing from FCS banks that operate under Title I of the Farm Credit Act. By repealing several non-statutory restrictions in 12 CFR Part 614, Subpart P, the proposed rule would make it easier for commercial banks and other OFIs identified in section 1.7(b)(1)(B) of the Act to fund or discount short- and intermediate-term loans to eligible borrowers through a Farm Credit bank. Under the proposed rule, any creditworthy OFI would be ensured access to System financing if it (1) makes at least 15 percent of loans to agricultural producers and (2) establishes a funding or discount relationship with an FCS bank for at least 2 years. The proposed rule would allow OFIs, under certain circumstances, to fund and discount loans through a System bank that is not chartered to serve their territory. Additionally, the proposed rule implements statutory requirements concerning OFIs and promotes equitable treatment by System banks of both OFIs and associations. This proposal enhances safety and soundness by requiring FCS banks to lend to OFIs only on a fully secured basis and to have full recourse to OFIs' capital. (Adopted June 12, 1997; published July 17, 1997 (62 FR 38223))

Capital Phase III – The most recent proposed modifications to FCA's capital regulations represent the FCA Board's continuing effort to ensure that appropriate risk-based capital standards are established and enforceable. The proposed rule would add safety and soundness requirements deferred from prior rulemaking, provide more consistency with capital requirements of other financial regulators, and make technical corrections. Specifically, the proposed amendments to 12 CFR Parts 611, 615, 620, and 627 would address interest rate risk as it pertains to System institutions, define insolvency for the purpose of appointing a receiver, establish capital and bylaw requirements for System service corporations, and make changes to risk-weighting categories. In addition, the proposed rule addresses the retirement of other allocated equities included in core surplus, deferred-tax assets, the treatment of intra-System investments for capital computation purposes, various other computational issues, and other technical issues. (Adopted August 14, 1997; published September 23, 1997 (62 FR 49623))

Leasing Authorities – The FCA Board proposed leasing regulations to provide System institutions, including the Farm Credit Leasing Services Corporation, clear and concise regulatory guidance concerning leasing activities. The proposed rule would address a number of issues regarding leasing, including underwriting standards, lease participations, borrower rights requirements, and stock requirements. The proposed rule would amend 12 CFR Parts 614, 618, and 621 and add a new Part 616. (Adopted September 11, 1997; published October 15, 1997 (62 FR 53581))

Examination

The FCA's Office of Examination conducted 159 examinations in FY 1997, including the examination of 131 FCS direct lender institutions, 19

Federal Land Bank Associations, the Federal Farm Credit Banks Funding Corporation, the FCS Financial Assistance Corporation, Farmer Mac, the Farm Credit Leasing Services Corporation, Farm Credit Financial Partners, Inc., and AgCo Services Corporation. In accordance with statutory authority, the OE also examined the National Consumer Cooperative Bank and the NCB Development Corporation, which are not FCS institutions.

Examinations are conducted according to risk-based examination practices whereby resources are deployed on the basis of each institution's level of risk. These risks are continuously identified, evaluated, and proactively addressed. When appropriate, off-site examinations are conducted on low-risk institutions, as determined by their capital, asset quality, management, earnings, and liquidity ratings. In FY 1997, 26 off-site examinations were conducted. Beginning in FY 1997, an 18-month examination cycle was implemented for institutions meeting certain criteria. Combined, the off-site examinations and the 18-month examination cycle allow efficient use of Agency resources and concentrate FCA's examination presence in higher risk institutions.

The FCA Rating System is similar to the Uniform Financial Institutions Rating System used by other Federal banking regulators; however, it has been modified to reflect the nondepository nature of FCS institutions. The ratings range from 1, which represents institutions that are basically sound in every respect, to 5, which represents institutions with extremely high immediate or near-term probability of failure. As of the end of FY 1997, there were no 5-rated institutions and only one 4-rated institution. Institutions rated 1 or 2 represented 95.3 percent and those rated 3 represented 4.2 percent of all rated FCS institutions.

The Agency has established several specialized developmental programs to train examiners in critical examination areas. Positions have been created for examiners with expertise in capital markets. These examiners receive ongoing training related to capital markets, interest rate risk and its measurement, asset pricing, investments, liquidity, and derivative products. Positions have also been established for information systems examiners. These examiners are specially trained to evaluate technical areas related to computer technology and information systems. Beyond these specialty areas, the Agency emphasizes staff training in various core examination areas.

During FY 1997, the OE established a quality assurance program to assess the results of the examination process, including the adequacy of risk identification and the achievement of corrective actions, and to ensure consistency of examination approaches.

The Agency continues to pursue ways to improve operating efficiency and enhance risk identification. It is developing electronic access to various FCS information systems to streamline portions of the examination process. During FY 1997, a standard system to electronically warehouse examination and institution information was developed. These projects result in greater efficiencies through use of electronic workflow methods. Development is underway for a uniform system to identify and respond to deteriorating trends in System institutions, including deterioration of loan underwriting standards.

During FY 1997, the System was notified that systematic disruptions and potential failures could result if computers cannot properly read date-sensitive information when the calendar year changes to 2000. An initial assessment of Year 2000 compliance by FCS institutions was conducted. A task force was established to monitor and assess the System's progress in addressing this issue. Focus on this area will continue until all institutions are Year 2000 compliant.

Enforcement

The FCA can use various forms of enforcement authority to ensure that the operations of FCS institutions are safe and sound and comply with statutes and regulations. This authority includes the power to enter into formal agreements; issue orders to cease and desist; levy civil money penalties; and suspend, remove, or prohibit officers, directors, and any other persons from participating in FCS institutions' affairs. If the FCA Board votes to take an enforcement action, the Office of Policy Development and Risk Control, in conjunction with the OE, oversees the performance of FCS institutions to ensure compliance.

The number of problem institutions and enforcement actions continued to decline during FY 1997. This trend reflects the Agency's efforts to reduce the risk to FCS institutions and their customers/shareholders, investors in

FCS obligations, and the Farm Credit System Insurance Corporation, as well as an improved agricultural economy. During FY 1997, one order to cease and desist was issued, and one agreement was executed. The Agency also issued two supervisory letters and three follow-up letters to institutions operating under existing enforcement actions.

The improving financial and credit conditions of FCS institutions, coupled with satisfactory compliance with existing enforcement actions, resulted in the Agency's terminating such actions on three institutions during FY 1997. At the end of FY 1996, six FCS institutions with aggregate assets of $927 million were under some form of enforcement action. At the end of FY 1997, five institutions with $2.9 billion in assets were under enforcement action. As of September 30, 1997, no institutions were in receivership or conservatorship.

Corporate Activity

During FY 1997, the FCA Board approved 14 corporate applications, consisting of nine association mergers, three association charter amendments for expansion of service territory, one bank charter amendment for a headquarters relocation, and one service corporation charter amendment to implement an ownership change. Figure 2 on page 16 depicts the chartered territories of FCS banks.

Audits and Investigations

During FY 1997, the Office of Inspector General (OIG) issued three audit reports – on the Agency Time Tracking System, FCA's Process for Complaints and Congressional Inquiries, and FCA's Use of Task Forces. In addition to these audits, the OIG contracted with Urbach Kahn & Werlin PC to audit the financial statements for the fiscal year ended September 30, 1996. It also contracted through the U.S. Department of Labor's Office of Inspector General with the independent accounting firm of Tichenor & Associates to audit the FCA's financial statements for the fiscal year ended September 30, 1997. The final audit report, included as part of this annual report, was issued on December 4, 1997.

The OIG administers an ongoing survey of FCS institutions. The survey is designed to provide the FCA Board with feedback concerning FCA's examination and enforcement activities. A report of results is issued each year.

Summaries of audit reports are published in the OIG's "Semiannual Report to the Congress." Copies of semiannual reports or audit 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. Semiannual reports also are available on FCA's Web page at www.fca.gov.

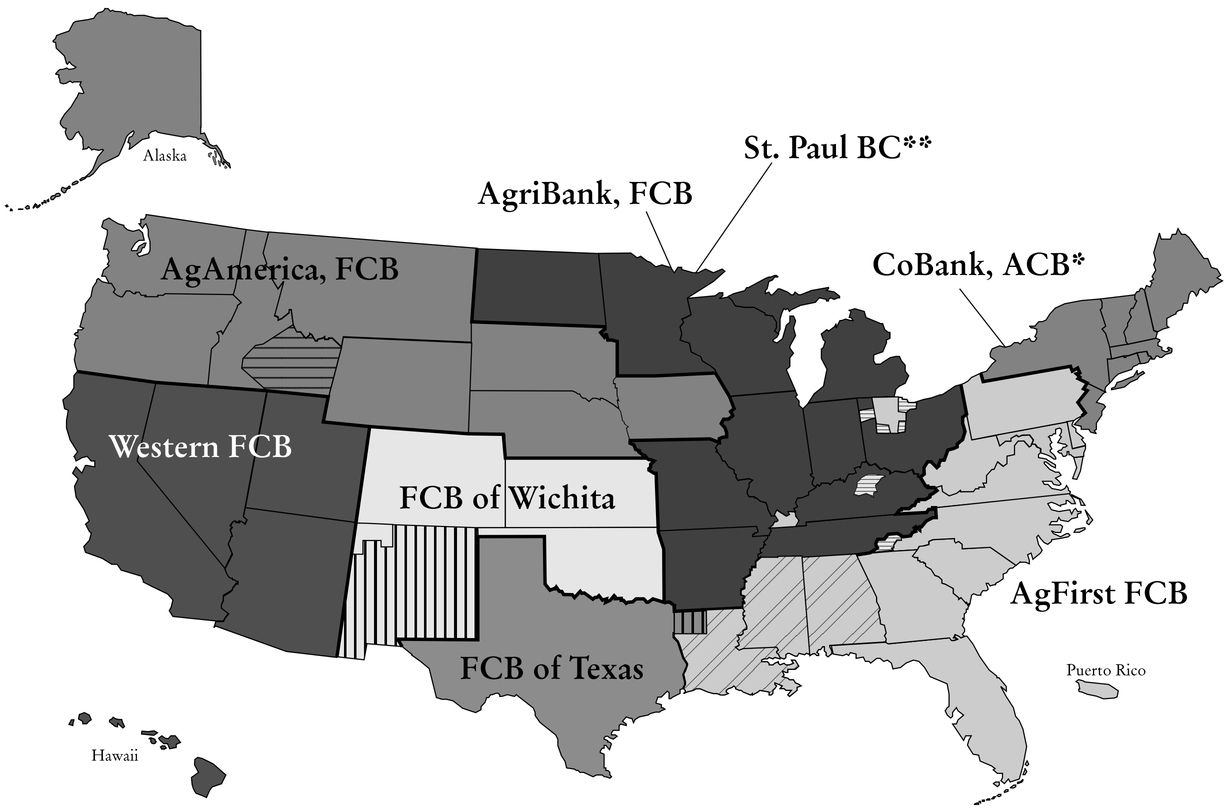
OIG investigations focus on violations of law or misconduct by FCA employees and contractors as well as allegations of irregularities or abuse in FCA programs and operations. Five investigations were open at the beginning of FY 1997. Two additional investigations were opened during the year. Four investigations were closed during the year, with three remaining open as of September 30, 1997. There were no criminal referrals or administrative actions following OIG investigations. The OIG Hotline (1-800-437-7322) is the primary vehicle used by Agency employees and the public to report fraud, waste, abuse, and mismanagement. The OIG received 84 Hotline calls or "walk-ins" during the year, and three investigations were opened based on the information received through these calls. All Hotline calls are carefully evaluated, investigated, or referred, as warranted.

Oversight of the Federal Agricultural Mortgage Corporation

Farmer Mac is regulated by the FCA through the Office of Secondary Market Oversight (OSMO), which was established in 1992, as required by Public Law 102-237, to provide for the general supervision of the safe and sound performance of Farmer Mac. The statute prescribes that the OSMO be a separate office whose activities are generally carried out by individuals not responsible for the supervision of other FCS institutions.

The OSMO's normal activities include monitoring Farmer Mac business activities and conducting the Farmer Mac annual examination. In addition, the OSMO was involved in implementing the provisions of the Farm Credit System Reform Act of 1996, by developing regulations governing Farmer Mac access to the Book-entry System of the Federal Reserve System; developing regulations for a Farmer Mac receivership or conservatorship, which were adopted by the FCA Board and became effective October 1, 1997; and continuing to research and develop risk-based capital regulations. The OSMO also continued to respond to a congressional request for joint monitoring of Farmer Mac's financial condition and operations by the FCA and Treasury.

Figure 2
Chartered Territories of Farm Credit System Banks
(As of September 30, 1997)



AgAmerica, FCB	Western FCB	FCB of Wichita	FCB of Texas	AgriBank, FCB	CoBank, ACB	AgFirst FCB
1 ACA	5 ACAs	22 FLBAs	31 FLBAs	11 ACAs	4 ACAs	39 ACAs
1 FLCA	11 FLCAs	18 PCAs	16 PCAs	19 FLCAs		1 PCA
1 PCA	10 PCAs			18 PCAs		

The Albuquerque and Eastern New Mexico PCAs are funded by the FCB of Texas. The Southern New Mexico PCA is funded by the FCB of Wichita.

The FLBAs in Alabama, Louisiana, and Mississippi generate and service loans for the FCB of Texas. The First South PCA is funded by AgFirst FCB.

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

*The CoBank, ACB serves cooperatives nationwide and ACAs in the indicated area.

**The St. Paul BC also serves cooperatives nationwide.

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

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

The Eastern Idaho ACA is funded by the Western FCB.

Farm Credit Administration Annual Financial Report

September 30, 1997

Farm Credit Administration

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

FCA
FARM CREDIT ADMINISTRATION

December 4, 1997

The Honorable Marsha Pyle Martin
Chairman of the Board
Farm Credit Administration
1501 Farm Credit Drive
McLean, Virginia

Dear Ms. Martin:

This report presents the opinion on the Farm Credit Administration's (FCA) Principal Statements for the fiscal years ended September 30, 1997 and 1996. Reports on the FCA's internal control structure and on its compliance with applicable laws and regulations are also provided.

The Office of Inspector General (OIG) contracted with Tichenor & Associates, Certified Public Accountants, to perform the audit. We ensured the quality of the audit work performed by monitoring the progress of the audit, reviewing supporting workpapers and performing other procedures deemed necessary to ensure compliance with Government Auditing Standards.

It is the opinion of Tichenor & Associates that the FCA's Principal Statements present fairly, in all material respects, the financial position of FCA as of September 30, 1997 and 1996, and the results of its operations and changes in net position, and its cash flows for the years then ended, in conformity with generally accepted accounting principles.

The Tichenor & Associates report on internal control structure disclosed no material weaknesses in internal controls; however it did disclose conditions existing during fiscal year 1997 which they considered to be reportable. Specifically, Tichenor & Associates reports that 1) there were inadequate procedures for recording asset acquisition and disposal in the financial management system; and 2) there was inadequate segregation of duties over payroll processing and personnel activities.

The Tichenor & Associates report on compliance with laws and regulations identified no instances of noncompliance that are required to be reported under Government Auditing Standards.

The fiscal year 1997 financial statement audit was conducted in accordance with generally accepted auditing standards and Government Auditing Standards, issued by the Comptroller General of the United States. The Principal Statements were prepared in accordance with generally accepted accounting principles.

The FCA's management is responsible for preparing the Annual Financial Statements in conformity with applicable standards, establishing and maintaining internal controls and systems, and complying with applicable laws and regulations.

During the course of its audit, Tichenor & Associates identified other matters which are not reportable but nevertheless warrant management's attention. These are being communicated in a separate letter for management's consideration.

Respectfully,

Eldon W. Stoehr
Inspector General

Farm Credit Administration
Report of Management

The management of the Farm Credit Administration (FCA or Agency) is responsible for the accompanying Statements of Financial Position as of September 30, 1997 and 1996, the related Statements of Operations and Changes in Net Position, and the Statements of Cash Flows. Amounts which must be based on estimates represent the best estimates and judgments of management. Management is responsible for the integrity, objectivity, consistency, and fair presentation of the financial statements and financial information contained in this Annual Financial Report (Report).

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

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

In the opinion of management, the financial statements present fairly the financial position of FCA at September 30, 1997, and September 30, 1996, and the results of operations and cash flows for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Marsha Pyle Martin
Chief Executive Officer

Donald P. Clark, Director
Office of Resources Management
and Chief Financial Officer

Bruce E. Ward, Director
Fiscal Resources Division

Management Discussion and Analysis

The following commentary reviews the financial condition and results of operations of the Farm Credit Administration (FCA or Agency) for the fiscal years (FYs) ended September 30, 1997, and September 30, 1996. This information should be read in conjunction with the financial statements, notes to the financial statements, and other sections of this annual report.

Summary

Operating expenses for FY 1997 were $36.0 million, a decrease of $4.4 million from FY 1996. In FY 1997, the Agency had $1.23 million of revenues in excess of expenses, compared with $540,000 of expenses in excess of revenues in FY 1996. Revenues for FY 1997 were $37.2 million, compared with $39.9 million in FY 1996. The Agency's budgetary obligations for FY 1997 were $2.4 million less than the $36.2 million approved by the FCA Board. The difference between obligations and operating expenses is due primarily to timing and is further explained in the notes to the financial statements. A reconciliation of budget and actual expenses is also provided in the notes to the financial statements.

Cash, Cash Equivalents, Investments, and Cash Flow

The Agency does not have borrowing authority from the U.S. Treasury. Almost all Agency cash is derived from assessments, reimbursable activity, and interest income. Cash over and above that needed to fund the annual operation of the Agency is taken into consideration in determining the subsequent amount to assess the Farm Credit System (FCS or System) institutions. The Agency is authorized to invest in public debt securities with maturities suitable to its needs.

Included in cash and cash equivalents are cash and short-term investments. Investments with maturities of one year or greater are classified as investments in the Statement of Financial Position. Cash and cash equivalents at the end of FY 1997 were $4.3 million more than that at the end of FY 1996. The change resulted from a $3.6 million increase in deferred revenue, a $1.7 million decrease in investments with maturities of one year or greater, and from normal operations.

Property and Equipment

At the end of FY 1997, net property and equipment amounted to $510,000, a decrease of $233,000 from $743,000 at the end of FY 1996. This decrease was primarily a result of depreciation recorded during the year in the amount of $494,000, offset by the purchase of computer hardware and software and copy machines. The purchase of the computer equipment is related to the new client/server computer architecture that will modernize the Agency's information systems and will result in future cost savings.

Rent

In accordance with the provisions of the Farm Credit Act of 1971, as amended, the Agency occupies facilities provided at no cost by the FCS Building Association (FCSBA), an entity owned by the System. Due to a change in accounting principle from early application of a Federal government accounting standard, the Agency has recorded rent expense in the results of operations along with a corresponding amount of imputed revenue. Rent expense for FY 1997 and FY 1996 was approximately $2.6 million for each year.

Accounts Payable

Accounts payable at the end of FY 1997 decreased to $453,500, from the $488,000 reported at the end of FY 1996. The decrease is related to the timing of invoice receipts and disbursements.

Accrued Payroll, Benefits, and Annual Leave

The amount of accrued payroll and benefits decreased by $341,000 from that outstanding at the end of FY 1996. Balances in these accounts are a result of timing between recognition of expenses and their actual payment. The FY 1997 balance represented approximately 1.2 pay periods, while the FY 1996 balance represents one full pay period accrual plus an estimate for severance payments and voluntary separation incentive payments (VSIPs). These severance payments and VSIPs are related to staff reductions as a result of the Five-Year Staffing and Structure Plan (Staffing Plan) implemented during FY 1996.

The decrease in the accrued annual leave liability represents the net decrease in the amount due to employees for annual leave earned but not yet taken, reduced by lump-sum leave payments to employees who have left the Agency.

Other Accrued Expenses

The $905,000 decrease in the liability for other accrued expenses from the $1.9 million reported in FY 1996 is largely a result of an adjustment to the accrual of employee moving expenses. As part of the Staffing Plan, certain employees were moved because of resource needs and workloads that reflect, among other things, structural changes taking place in the System.

Deferred Revenue

Deferred revenue is the difference between (1) the amounts received from assessments and other reimbursable activity, interest, and other income and (2) the amount the Agency needs to fund budgetary obligations and maintain necessary reserves. The FY 1998 assessments were reduced by $3.4 million of the balance of deferred revenue outstanding at the end of FY 1997. The deferred revenue account will reflect this reduction in FY 1998.

Prepaid Assessments

Certain System institutions historically prepay part of their first quarter fiscal year assessment, which is due by the beginning of the fiscal year. The FY 1997 amount is approximately $1.2 million less than the FY 1996 amount because fewer institutions elected to prepay and because the first quarter assessment amount was reduced.

Total Revenues

The Agency receives most of its revenue from assessments paid by System institutions and reimbursable activity. This revenue funds the administrative expenses of the Agency and the acquisition of fixed assets. Revenue is also generated from interest earned on investments, imputed financing, and other miscellaneous sources. The imputed financing offsets the expense recorded for the Agency's pension and post-retirement health and life insurance benefits, and rent expense.

Interest income for FY 1997 was $21,000 less than FY 1996, chiefly as a result of a decrease in the average rate of interest earned on cash equivalents and investments from 4.97 percent in FY 1996 to 4.55 percent in FY 1997. The average daily amount invested was $14.0 million in FY 1996 and $15.0 million in FY 1997. Other income recorded by the Agency was approximately $24,000 higher than that recorded during FY 1996 and consisted primarily of an increase in income from the sale of fixed assets and a decrease in income from other miscellaneous sources.

Operating Expenses

Total operating expenses for the Agency in FY 1997 and FY 1996 were approximately $36.0 million and $40.4 million, respectively. The increase in travel expenses of $200,000 from FY 1996 is a result of an increase in travel costs associated with relocations and an examination workshop held during the year. The pension and postretirement health and life insurance benefits expenses, and rent expense are nonmonetary transactions that offset the imputed financing revenue.

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INDEPENDENT AUDITOR'S REPORT

FARM CREDIT ADMINISTRATION
The Board and Office of Inspector General

We have audited the accompanying statements of financial position of the Farm Credit Administration (FCA) as of September 30, 1997, and the related statements of operations and changes in net position, and cash flows for the year then ended. These financial statements are the responsibility of the Farm Credit Administration's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of Farm Credit Administration as of September 30, 1996, were audited by other auditors whose opinion dated November 7, 1996 expressed an unqualified opinion on these statements. As discussed in Note 2, the Farm Credit Administration has restated its 1996 financial statements during the current year to recognize rent expense and postretirement benefits and the associated revenues, in conformity with generally accepted accounting principles. The other auditors reported on the 1996 financial statements before the restatement.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 1997 financial statements referred to above present fairly, in all material respects, the financial position of Farm Credit Administration as of September 30, 1997, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles.

We also audited the adjustments described in Notes 13 and 14 that were applied to restate the 1996 financial statements. In our opinion, such adjustments are appropriate and have been properly applied.

In accordance with *Government Auditing Standards,* we have also issued a report dated November 14, 1997, on our consideration of Farm Credit Administration's control structure and a report also dated November 14, 1997, on its compliance with laws and regulations.

TICHENOR & ASSOCIATES
Woodbridge, Virginia
November 14, 1997

TICHENOR & ASSOCIATES

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INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL STRUCTURE

FARM CREDIT ADMINISTRATION
The Board and Office of Inspector General

We have audited the financial statements of the Farm Credit Administration (FCA) as of and for the year ended September 30, 1997, and have issued our report thereon dated November 14, 1997.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The management of FCA is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit of the financial statements of FCA for the year ended September 30, 1997, we obtained an understanding of the internal control structure. With respect to the internal control structure, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control structure. Accordingly, we do not express such an opinion.

We noted two matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the entity's ability to record, summarize, and report financial data consistent with the assertions of management in the financial statements. The reportable conditions we noted are as follows:

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL STRUCTURE, CONTINUED

Inadequate procedures for recording asset acquisition and disposal in the financial management system

No formal procedures exist to assure that assets acquired, sold, donated, retired, or otherwise disposed of are reported to the Fiscal Resources Division (FRD) by the Property Management Official for proper recording in the general ledger system. No reconciliation is performed of information in the Property Management Tracking System (PMTS) and the general ledger to assure that acquisition and disposal of all capitalized assets is properly recorded. As a result, the PMTS is not reliable for financial information, and does not always agree with cost information in the general ledger. As a result, extensive efforts were required at year end to correct the general ledger balance to reflect actual fixed assets for financial statement reporting.

We recommend procedures be developed to assure communication between the Property Management Official and FRD regarding asset acquisition and disposition. In addition, we recommend that management require reconciliation of accounting records to the PMTS, and implement a policy that periodic reconciliations be performed, no less frequently than annually.

Inadequate segregation of duties over payroll processing and personnel actions

The Personnel/Payroll and Transactions Branch processes both payroll and personnel actions. As a result, employees have incompatible duties. The same employees have the ability to initiate a personnel action and process payroll information. Compensating controls are not formalized, nor are procedures in place to detect errors or irregularities on a day to day basis. In addition, there is no independent review of payroll to identify errors, "ghost employees" or overpayments.

We recommend FCA segregate the personnel and payroll functions. The function of payroll processing should be assigned to an individual who is not authorized to make personnel changes in the payroll system. In addition, payroll review procedures and compensating controls should be formalized and documented to ensure the system of internal control is adequate and functioning properly.

A material weakness is a reportable condition in which the design or operation of one or more of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities 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.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we believe none of the reportable conditions described above is a material weakness.

We also noted other matters involving the internal control structure and its operation that we have reported to FCA's management in a separate letter dated November 14, 1997.

This report is intended for the information of the Board and the Office of Inspector General and management of FCA. However, the report is a matter of public record and its distribution is not limited.

TICHENOR & ASSOCIATES
Woodbridge, Virginia
November 14, 1997

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INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

FARM CREDIT ADMINISTRATION
The Board and Office of Inspector General

We have audited the financial statements of the Farm Credit Administration (FCA) for the year ended September 30, 1997, and have issued our report thereon dated November 14, 1997.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Compliance with laws and regulations applicable to FCA is the responsibility of FCA's management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of FCA's compliance with certain provisions of applicable laws and regulations. However, the objective of our audit of the financial statements was not to provide an opinion of overall compliance with such provisions. Accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance that are required to be reported herein under *Government Auditing Standards*.

This report is intended for the information of the Board and the Office of Inspector General and management of FCA. However, this report is a matter of public record and its distribution is not limited.

TICHENOR & ASSOCIATES
Woodbridge, Virginia
November 14, 1997

FARM CREDIT ADMINISTRATION
STATEMENTS OF FINANCIAL POSITION

	September 30 1997	September 30 1996
ASSETS		
Cash and cash equivalents (Note 3)	$14,476,023	$ 10,181,390
Investments (Note 4)	530,991	2,228,204
Accounts receivable (Note 5)	198,265	283,081
Prepaid expenses	112,411	140,037
Life insurance fund (Note 6)	36,171	72,402
Net property and equipment (Note 7)	510,261	743,445
TOTAL ASSETS	$15,864,122	$ 13,648,559
LIABILITIES AND NET POSITION		
LIABILITIES		
Accounts payable (Note 8)	$ 453,474	$ 488,222
Accrued payroll and benefits	1,377,122	1,717,848
Accrued annual leave	2,165,791	2,242,342
Other accrued expenses	996,544	1,901,800
Deferred revenue (Note 9)	6,664,186	3,113,929
Prepaid assessments (Note 10)	2,230,259	3,435,046
TOTAL LIABILITIES	$13,887,376	$12,899,187
NET POSITION (Note 11)	1,976,746	749,372
TOTAL LIABILITIES AND NET POSITION	$15,864,122	$13,648,559

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

FARM CREDIT ADMINISTRATION
STATEMENTS OF OPERATIONS AND CHANGES IN NET POSITION

	For the Year Ended September 30 1997	1996
REVENUES		
Assessments and reimbursable revenue	$32,345,408	$34,777,585
Imputed financing (Notes 13 and 14)	4,135,656	4,363,856
Interest	680,883	702,261
Other	79,485	55,252
TOTAL REVENUES	37,241,432	39,898,954
EXPENSES		
Salaries	23,462,275	24,279,054
Benefits (Note 12)	2,435,215	5,872,677
Pension and other benefits (Note 14)	3,436,167	3,693,789
Rent (Note 13)	2,580,435	2,616,186
Other operating expenses	1,896,379	1,993,645
Travel	1,709,597	1,502,088
Depreciation	493,990	481,254
TOTAL EXPENSES	36,014,058	40,438,693
EXCESS REVENUES (EXPENSES) OVER EXPENSES (REVENUES)	1,227,374	(539,739)
Net position, beginning of year	749,372	1,289,111
Net position, end of year	$ 1,976,746	$ 749,372

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

FARM CREDIT ADMINISTRATION
STATEMENTS OF CASH FLOWS

	For the Year Ended September 30 1997	1996
CASH FLOWS FROM OPERATING ACTIVITIES		
CASH PROVIDED:		
Assessments and reimbursable revenue	$34,950,146	$33,971,834
Liquidation of health insurance rate stabilization fund	0	112,905
Interest on investments	658,555	664,608
Other revenues	79,485	55,252
Total cash provided by operating activities	35,688,186	34,804,599
CASH USED:		
Salaries and benefits	(28,131,855)	(31,457,955)
Travel	(1,722,263)	(1,570,338)
Cash paid to vendors	(2,998,171)	(3,684,733)
Total cash used by operating activities	(32,852,289)	(36,713,026)
Net cash provided (used) by operating activities	2,835,897	(1,908,427)
CASH FLOWS FROM INVESTING ACTIVITIES		
Payments for purchase of equipment	(260,806)	(222,548)
Redemption (Purchase) of investments	1,719,542	(2,195,939)
Net cash provided (used) by investing activities	1,458,736	(2,418,487)
Net Increase (Decrease) In Cash And Cash Equivalents	4,294,633	(4,326,914)
Cash and cash equivalents, beginning of year	10,181,390	14,508,304
Cash and cash equivalents, end of year	$14,476,023	$10,181,390
RECONCILIATION OF NET INCOME TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES		
Excess of revenues (expenses) over expenses (revenues)	$ 1,227,374	($ 539,739)
Adjustments to reconcile excess of revenues (expenses) over expenses (revenues) to net cash provided (used) by operating activities:		
Depreciation	493,990	481,254
Amortization of premium/discount on investments	(22,329)	(32,263)
Changes in:		
Accounts receivable	84,816	(55,277)
Prepaid expenses	27,626	(124,129)
Life insurance fund	36,231	24,713
Health insurance fund	0	112,905
Accounts payable	(34,748)	(3,168,741)
Accrued payroll and benefits	(340,726)	597,643
Accrued annual leave	(76,551)	12,151
Deferred revenue	3,550,257	(8,796)
Prepaid assessments	(1,204,787)	(690,893)
Other accrued expenses	(905,256)	1,482,745
Net cash provided (used) by operating activities	$ 2,835,897	($ 1,908,427)

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

Notes to Financial Statements

NOTE 1. ORGANIZATION AND MISSION

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.

The System is a nationwide network of borrower-owned lending institutions and specialized service organizations. System institutions consist of six Farm Credit Banks, one Agricultural Credit Bank and their related associations; one Bank for Cooperatives; and other related entities. The institutions within the System provide credit and credit-related services to farmers, ranchers, producers and harvesters of aquatic products, rural homeowners, certain farm-related businesses, agricultural and aquatic cooperatives, rural utilities, and certain foreign and domestic entities in connection with international activities.

FCA operates under authorities conferred by the Act. FCA operations are financed by a revolving fund that is reimbursed primarily from assessments received from System institutions examined by FCA. Institutions are assessed or otherwise charged directly and billed in accordance with a formula established by FCA regulations for services performed by FCA. All of FCA's administrative expenses are paid by the institutions it examines, regulates, or for which it provides reimbursable services. In accordance with FCA regulations, adjustments of the assessments paid shall be based on FCA's administrative operating expenses incurred in the applicable fiscal year, plus any funds required to maintain reserves pursuant to the Act. Historically, the amount credited has been based on the amount received by FCA, either from direct assessments, reimbursable activity, or other sources, compared to that obligated by FCA for operating expenses. In recent years, there have been no adjustments that resulted in additional charges to the institutions.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of accounting - The accompanying financial statements have been prepared in accordance with generally accepted accounting principles (GAAP). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. FCA's transactions are recorded on the accrual basis of accounting. Under this method, revenues are recognized when earned, and expenses are recognized when liabilities are incurred, without regard to payment of cash. Certain amounts in prior year financial statements have been reclassified to conform to current financial statement presentation.

The Chief Financial Officers Act of 1990 (CFO Act) required certain Federal agencies to develop financial statements that provide information useful to Congress, Government officials, and the public. FCA is not mandated to adhere to the CFO Act, however, Agency management has voluntarily elected to develop financial statements and have those statements audited. Although Office of Management and Budget (OMB) Bulletin 97-01, *Form and Content of Agency Financial Statements*, prescribes a framework for Federal agencies to develop financial statements, FCA's financial statements are not presented in conformity with this bulletin. FCA management believes presentation under GAAP more fully discloses the Agency's financial position, results of operations and changes in net position, and cash flows. In this regard, a Statement of Budgetary Resources and Actual Expense is not included as one of FCA's principal statements. The relevant information for fiscal year (FY) 1997, however, is provided in Note 16 to the financial statements.

Notes to Financial Statements

Cash and cash equivalents - Cash and cash equivalents consist of the fund balance with the U.S. Treasury, an imprest fund, the balance of the flexible spending account and short-term, highly liquid investments with Treasury having maturities of less than one year. The market value of the investments with the U.S. Treasury is equivalent to cost.

Investments - FCA is authorized by the Act to invest in public debt securities with maturities suitable to FCA's needs. All investments are classified as held to maturity and carried at cost, adjusted for unamortized premiums or discounts. Premiums and discounts are amortized using the straight-line method (which approximates the interest method) over the term of the respective issues. All long-term investments have maturities of one year or greater. By law, FCA must invest and redeem through the U.S. Treasury and has no opportunity to recognize holding gains or losses. Since FCA cannot incur these gains or losses, unrecognized gains and losses are not reported.

Property and equipment - As more fully disclosed under Note 7, property and equipment are recorded at cost, net of an allowance for accumulated depreciation. Repairs and maintenance costs are expensed as incurred. Property and equipment that costs $5,000 or more is capitalized. The straight-line method of depreciation with half year convention is utilized to allocate the cost of capitalized property and equipment over estimated useful lives of three years.

Rent - In accordance with the Act, FCA occupies buildings and uses land owned and leased by the FCS Building Association (FCSBA), an entity owned by System banks. While FCSBA is privately owned, oversight of its activities is vested with the FCA Board. FCA is not charged for the use of the buildings or land, owned or leased, and FCSBA is responsible for maintenance and repair of buildings and land improvements. There has been a change in accounting principle for the rent expense and associated revenue due to early application of Statement of Federal Financial Accounting Standards (SFFAS) Number 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*. Rent expense is recorded at cost based on information provided by the FCSBA. The prior year has been restated to include the rent expense and a corresponding amount of imputed revenue.

Pension and postretirement health and life insurance benefits - Each employing Federal agency is required to recognize its share of the cost and imputed financing of providing pension and postretirement health benefits and life insurance, effective with fiscal years beginning after September 30, 1996. This is a change in accounting principle as required by SFFAS Number 5, *Accounting for Liabilities of the Federal Government.* Factors used in the calculation of these pension and postretirement health and life insurance benefits expenses were provided by the Office of Personnel Management (OPM) to each agency to meet this requirement. The prior year has been restated to include this expense and a corresponding amount of imputed revenue.

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

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 overall financial health of the institution being assessed.

Notes to Financial Statements

NOTE 3. CASH AND CASH EQUIVALENTS

Cash and cash equivalents consisted of the following:

	September 30 1997	September 30 1996
Revolving fund	$ 1,134,039	$ 1,193,704
Cash equivalents	13,341,984	8,987,686
	$14,476,023	$10,181,390

Interest income earned on cash and cash equivalents approximated $496,000 and $662,000 for FY 1997 and FY 1996, respectively.

NOTE 4. INVESTMENTS

The maturity, amortized cost, and yield of the investment securities were as follows:

	September 30 1997	September 30 1996
U.S. Treasury securities		
Amortized cost	$530,991	$2,228,204
Yield	6.75%	5.49%
Maturity	June 30, 1999	June 27, 1997

Interest income earned on long term investments was $95,896 and $32,263 for FY 1997 and FY 1996, respectively.

NOTE 5. ACCOUNTS RECEIVABLE

Accounts receivable consisted of the following:

	September 30 1997	September 30 1996
Assessments due from assessed institutions and Non-System entities	$130,543	$181,863
Related parties:		
FCS Insurance Corporation (FCSIC)	34,059	76,541
FCSBA	0	15,000
Miscellaneous other receivables	33,663	9,677
	$198,265	$283,081

Notes to Financial Statements

NOTE 6. LIFE INSURANCE FUND

The FCA life insurance rate stabilization fund was as follows:

	September 30	
	1997	1996
Life insurance fund	$36,171	$72,402

Interest earned on this fund approximated $2,565 and $7,600 for FY 1997 and FY 1996, respectively.

NOTE 7. PROPERTY AND EQUIPMENT

Property and equipment consisted of the following:

	September 30	
	1997	1996
Office equipment	$1,909,606	$2,146,811
Less accumulated depreciation	(1,399,345)	(1,403,366)
	$ 510,261	$ 743,445
Depreciation expense	$ 493,990	$ 481,254

NOTE 8. ACCOUNTS PAYABLE

Accounts payable consisted of the following:

	September 30	
	1997	1996
Federal sources	$ 81,520	$ 39,641
Related party:		
FCSBA	72,515	134,566
Other	299,439	314,015
	$453,474	$488,222

NOTE 9. DEFERRED REVENUE

Deferred revenue represents the cumulative excess of all funds received by FCA from direct assessments, reimbursable activities, and other sources over obligations incurred. These amounts generally will be used to reduce assessments in a subsequent fiscal year. Prior to FY 1997, deferred revenue was refunded to the System institutions through an adjustment in the quarterly assessment payments of the current year. The adjustment to the assessments in FY 1997 did not impact deferred revenue. An amount of $3.4 million was used to reduce the assessments for FY 1998.

Notes to Financial Statements

NOTE 10. PREPAID ASSESSMENTS

Prepaid assessments represent prepayments received from assessed institutions as of the end of the fiscal year. Such amounts will be used to fund subsequent fiscal year operations.

NOTE 11. NET POSITION

Changes in the individual components of net position occurred as follows during FY 1997:

	Unexpended Obligations	Net Capital Invested in Fixed Assets	Future Funding Requirements	Total
Beginning balance October 1, 1996	$ 567,549	$ 743,445	($ 561,622)	$ 749,372
Excess of FY 1997 revenues over expenses	978,525	(233,184)	482,033	1,227,374
Ending balance September 30, 1997	$1,546,074	$ 510,261	($ 79,589)	$ 1,976,746

The balance in net position generally represents the difference between: (1) items that have been obligated for budgetary purposes, and (2) expenses recorded on the accrual basis of accounting. Unexpended obligations represent items that do not meet the criteria for recording liabilities, but are appropriately recognized as obligations of budgetary resources and, in most cases, will result in future recognition of expenses. The balance in the Future Funding Requirements account represents items that have been accrued in accordance with GAAP, but have not been obligated for budgetary purposes. This amount relates to severance payments and the voluntary separation incentive payments (VSIP) accrued as a result of the Staffing Plan. The investment in fixed assets represents items that were fully expended for budgetary purposes but are being depreciated in accordance with GAAP.

NOTE 12. BENEFITS

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

Health benefits and life insurance - Health benefits and group life insurance are provided through the Federal Employees Health Benefits (FEHB) plan and the Federal Employees Group Life Insurance (FEGLI) plan. Group life insurance may also be obtained through an FCA plan. Under these plans, premium costs are shared between FCA and the employees. FCA life insurance may be obtained separately from, or in combination with, FEGLI.

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

Notes to Financial Statements

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. 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.

Employee assistance and wellness program - FCA funds an employee assistance and wellness program to increase employee efficiency and productivity. The employee assistance program is designed to assist employees who voluntarily seek counseling or who have been encouraged by their supervisors to seek counseling. The employee wellness program provides annual reimbursement up to $150 for periodic, routine physical examination or health screening costs that are not covered by health insurance.

NOTE 13. RENT

	September 30	
	1997	**1996**
Leased field offices	$ 975,503	$ 974,140
FCA headquarters	1,604,932	1,642,046
	$2,580,435	$2,616,186

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 rent expense and the associated imputed revenue are recorded as a non-monetary transaction in accordance with an early application of SFFAS Number 4 (see Note 2). In accordance with SFFAS Number 4, 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 tenants renting office space. The lease expenses for the field offices are included in FCSBA's gross operating expenses. The fair value of the facilities provided by FCSBA at no cost to FCA for FY 1997 and FY 1996 was approximately $3.4 million and $3.3 million, respectively.

NOTE 14. PENSION AND OTHER RETIREMENT BENEFITS

	September 30	
	1997	**1996**
Funded pension cost	$1,880,946	$1,946,119
Imputed pension cost	843,660	1,117,660
Other imputed retirement benefits	711,561	630,010
	$3,436,167	$3,693,789

Notes to Financial Statements

Retirement - FCA's 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 plans, 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 Number 5 (see Note 2). A corresponding amount of imputed revenue is recorded to offset the expense.

Other retirement benefits expenses - SFFAS Number 5 (see Note 2) 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 15. CONGRESSIONAL LIMITATION ON ADMINISTRATIVE EXPENSES

Except for FY 1996, Congress has placed an annual spending limit on the amount of administrative expenses that can be obligated by FCA in a given fiscal year, exclusive of reimbursable activities. The statutory limitation for FY 1997 was $37,478,000. During FY 1997, FCA had direct obligations of approximately $33,506,000 subject to the limitation. In addition, during FY 1997, FCA incurred obligations of approximately $270,000 related to reimbursable activities.

NOTE 16. RECONCILIATION OF BUDGET AND ACTUAL EXPENSES

The reconciliation between budgetary obligations and accrued expenses as of September 30, 1997, is as follows:

Budget resources		$36,199,719
Budgetary obligations:		
	Direct	$33,506,284
	Reimbursed	270,016
		$33,776,300
Actual expenses		$36,014,058
Add:	FY 1997 undelivered orders	1,457,197
	FY 1997 purchases of fixed assets	260,806
	Rate stabilization fund adjustment	(38,796)
	Other	2,247
Less:	FY 1997 depreciation expense	493,990
	Liquidation of prior year undelivered orders	(230,001)
	Reimbursement of prior year credit memos	1,601
	Adjustment of future funding requirements	(482,034)
	OPM pension and postretirement expenses	1,555,221
	Rent expense	2,580,435
Budgetary obligations		$33,776,300

Notes to Financial Statements

NOTE 17. RELATED PARTIES

FCSIC was established to provide an insurance function for the FCS. FCA provides staff resources to FCSIC on a reimbursable basis. Services provided by FCA staff include examinations and administrative and legal support services. Services to FCSIC totaled approximately $206,000 and $170,000 for FY 1997 and FY 1996, respectively. 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.

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. As stated in Note 13, in accordance with the Act, FCA occupies buildings owned and leased by FCSBA. Rent is provided at no cost to FCA. FCSBA also leases telecommunications equipment to FCA under a reimbursable operating lease that is renewable annually. Telecommunications expenses were $278,870 and $270,739 for FY 1997 and FY 1996, respectively. The FCA Board has exclusive oversight of the FCSBA and is authorized to act as the agent of the banks.

Glossary

A

ACA – The acronym for Agricultural Credit Association.

ACB – The acronym for Agricultural Credit Bank.

Act – The abbreviated term for the Farm Credit Act of 1971, as amended.

AgAmerica, FCB – This is the Farm Credit Bank (FCB) that was formed April 1, 1994, as a result of the consolidation of the FCB of Omaha and the FCB of Spokane. AgAmerica provides loan funds and support services to the associations serving Alaska, Idaho, Iowa, Montana, Nebraska, Oregon, South Dakota, Washington, and Wyoming. On March 1, 1997, an agreement became effective that placed AgAmerica and the Western FCB under joint management and moved AgAmerica's headquarters from Spokane, Washington, to Sacramento, California.

Agency – When capitalized, the term refers to the Farm Credit Administration.

AgFirst Farm Credit Bank – Headquartered in Columbia, South Carolina, this institution provides loan funds and support services to associations serving Delaware, the District of Columbia, Florida, Georgia, Maryland, North Carolina, Pennsylvania, Puerto Rico, South Carolina, Virginia, West Virginia, and parts of Kentucky, Ohio, and Tennessee. It also provides short- and intermediate-term financing to associations serving Alabama, Louisiana, and Mississippi. AgFirst was formed on April 1, 1995, as a result of a consolidation of the FCB of Columbia and the FCB of Baltimore.

AgriBank, FCB – AgriBank was formed on May 1, 1992, as a result of a consolidation of the FCB of St. Louis and the FCB of St. Paul. In January 1994, the FCB of Louisville merged into AgriBank. AgriBank provides loan funds and support services to the associations serving Arkansas, Illinois, Indiana, Kentucky, Michigan, Minnesota, Missouri, North Dakota, Ohio, Tennessee, and Wisconsin.

Agricultural Credit Association (ACA) – An ACA results from the merger of a Federal Land Bank 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 or harvesters of aquatic products. It also makes loans to these borrowers for certain processing and marketing activities, to rural homeowners for housing, and to certain farm-related businesses.

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

Associations – A collective term often used to describe the local entities that serve as the delivery points for credit to farmers, ranchers, producers or harvesters of aquatic products, and rural homeowners. The four types of associations are Agricultural Credit Associations, Federal Land Bank Associations, Federal Land Credit Associations, and Production Credit Associations.

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 St. Paul BC is the only BC in the Farm Credit System.

BC – The acronym for Bank for Cooperatives.

C

Call Report – A call report is a statement of condition and performance of an FCS bank or association. FCS banks and associations are required to file call reports quarterly with the Farm Credit Administration.

CoBank, ACB – CoBank originally was formed by the merger of 10 of the 12 district Banks for Cooperatives and the Central Bank for Cooperatives on January 1, 1989. The resulting institution was the National Bank for Cooperatives. On January 1, 1995, CoBank became the only ACB in the Farm Credit System when it consolidated with the FCB of Springfield (Massachusetts) and the Springfield Bank for Cooperatives. Its headquarters is in Denver, Colorado, and it has the combined lending authority of an FCB (in its

Northeast Region only, with associations serving Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, New York, Rhode Island, and Vermont) and a Bank for Cooperatives. It also is authorized to finance U.S. agricultural exports and provide international banking services for farmer-owned cooperatives.

F

Farm Credit Act (the 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 Administration (FCA or Agency) – The FCA is the independent Federal agency responsible for examining and regulating Farm Credit System institutions. The FCA was created by Executive order in 1933 and derives its powers and authorities from the Farm Credit Act of 1971, as amended. The Agency's headquarters is in McLean, Virginia.

Farm Credit Administration Board – The three-member Farm Credit Administration Board is the policymaking body for the Farm Credit Administration. Members are appointed by the President with the advice and consent of the U.S. Senate to 6-year terms on the Board. Members may not be reappointed after serving a full term or more than 3 years of a previous member's term. The President designates one of the members as chairman of the Board, who also serves as chief executive officer.

Farm Credit Bank (FCB) – On July 6, 1988, the Federal Land Bank and the Federal Intermediate Credit Bank in 11 of the 12 Farm Credit districts merged to become FCBs. The mergers were required by the Agricultural Credit Act of 1987. FCBs generally provide services and funds to local associations that, in turn, lend those funds to farmers, ranchers, producers or harvesters of aquatic products, rural residents for housing, and some agriculture-related businesses. As of September 30, 1997, there were six FCBs: AgAmerica, FCB; AgFirst FCB; AgriBank, FCB; Farm Credit Bank of Texas; Farm Credit Bank of Wichita; and Western Farm Credit Bank.

Farm Credit Bank of Texas – Headquartered in Austin, Texas, this institution provides services and short- and intermediate-term financing to associations serving Texas and parts of Louisiana and New Mexico. It provides services and long-term financing to associations serving Alabama, Louisiana, Mississippi, and Texas.

Farm Credit Bank of Wichita – Headquartered in Wichita, Kansas, this institution provides services and short-, intermediate-, and long-term financing to associations serving Colorado, Kansas, and Oklahoma, and short- and intermediate-term financing to part of New Mexico.

Farm Credit Leasing Services Corporation (Leasing Corporation) – The Leasing Corporation is a service entity owned by Farm Credit System banks to provide equipment leasing and related services to eligible borrowers, including agricultural producers, cooperatives, and rural utilities.

Farm Credit System (FCS or System) – The FCS is a nationwide network of financial cooperatives. Borrowers include farmers, ranchers, rural homeowners, agricultural cooperatives, rural utility systems, and agribusinesses.

Farm Credit Insurance Fund (Insurance Fund) – The Insurance Fund represents the Farm Credit System Insurance Corporation's equity, i.e., the difference between its total assets and its total liabilities, including its insurance obligations.

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. 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.

Farmer Mac – The abbreviated term for Federal Agricultural Mortgage Corporation.

FCA – The acronym for Farm Credit Administration.

FCA Rating System – The FCA Rating System is similar to the Uniform Financial Institutions Rating System used by other Federal banking regulators; however, it has been modified to reflect the nondepository nature of FCS institutions. 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 minor and 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 than institutions with lower ratings of withstanding the uncertainties of business conditions. 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. While areas of weakness could develop into conditions of greater concern, regulatory response is limited as long as minor adjustments are resolved in the normal course of business and operations continue in a satisfactory manner.

Rating 3 – Institutions in this group 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. Institutions in this group 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 impair future viability or constitute a threat to the interests of investors, borrowers, and stockholders. A potential for failure is present but not yet imminent or pronounced. Institutions in this group 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 demand urgent external financial assistance. In the absence of decisive corrective measures, these institutions will likely require liquidation or some form of emergency assistance, merger, or acquisition.

FCB – The acronym for Farm Credit Bank.

FCS – The acronym for Farm Credit System.

FCSBA – The acronym for FCS Building Association.

FCSIC – The acronym for Farm Credit System Insurance Corporation.

FCS Building Association (FCSBA or Building Association) – The FCSBA acquires, manages, and maintains facilities for the FCA's headquarters and field offices. Formed in 1981, the FCSBA is owned by the FCS banks; however, oversight of its activities is vested in the FCA Board.

Federal Agricultural Mortgage Corporation (Farmer Mac) – Farmer Mac was created by the Agricultural Credit Act of 1987 to provide guarantees for the timely repayment of principal and interest on securities backed by pools of agricultural real estate or rural home loans. Farmer Mac is controlled by an independent 15-member board composed of 5 representatives from the Farm Credit System, 5 members from commercial banks and insurance companies, and 5 public members appointed by the President. Farmer Mac is regulated by the FCA and is defined by statute as a Farm Credit System institution.

Federal Farm Credit Banks Funding Corporation (Funding Corporation) – Based in Jersey City, New Jersey, the Funding Corporation 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, 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 are lending agents for Farm Credit Banks. FLBAs make and service long-term mortgage loans to farmers, ranchers, and rural residents for housing. FLBAs do not own loan assets but make loans only on behalf of the Farm Credit Bank with which they are affiliated.

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.

FICB – The acronym for Federal Intermediate Credit Bank.

FLCA – The acronym for Federal Land Credit Association.

FLB – The acronym for Federal Land Bank.

FLBA – The acronym for Federal Land Bank Association.

Funding Corporation – The abbreviated term for Federal Farm Credit Banks Funding Corporation.

L

Leasing Corporation – The abbreviated term for Farm Credit Leasing Services Corporation.

P

PCA – The acronym for Production Credit Association.

Production Credit Association (PCA) – The Farm Credit Act of 1933 authorized farmers to organize PCAs that could discount notes with Federal Intermediate Credit Banks. 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 loan to farmers. PCAs also own their loan assets.

S

System – When capitalized, the term refers to the Farm Credit System.

W

Western Farm Credit Bank – Headquartered in Sacramento, California, this institution provides loan funds and services to the associations serving Arizona, California, Hawaii, part of Idaho, Nevada, and Utah.

Y

Year 2000 – The Year 2000 issue refers to the problem posed by the century date change for most computer operating systems and programs, which are unable to distinguish the year 1900 from the year 2000. Most computer operating systems and programs currently in use have six-digit date fields (YYMMDD), which represent, for example, December 31, 1999, by 991231. The six-digit field, with only two digits for the year, is the basis for all date-related calculations within most computer systems, particularly mainframes. Unless the systems are changed, when the year 2000 arrives, they will have no way of expressing a date past year-end 1999: They will interpret 000101 as January 1, 1900.

Additional Information

A discussion of the financial condition and performance of the Farm Credit System (FCS or System) may be found in the Farm Credit Administration (FCA) report *Risk Analysis of Farm Credit System Operations*, published for the quarters ended March 31, June 30, and September 30, and FCA's *Report on the Financial Condition and Performance of the Farm Credit System.* Depending on availability, these publications may be obtained without charge from:

Office of Congressional and Public Affairs
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090
Telephone: (703) 883-4056
Fax: (703) 790-3260
E-mail: info-line@fca.gov

Also, the 1996 editions of these publications and the *1997 FCA Annual Report* are now available on FCA's Web site at http://www.fca.gov.

Disclosure to investors in System securities is made by the Federal Farm Credit Banks Funding Corporation through annual and quarterly information statements, published as part of the *Report to Investors of the Farm Credit System.* Copies of this report are available from:

Federal Farm Credit Banks Funding Corporation
10 Exchange Place
Suite 1401
Jersey City, NJ 07302
Telephone: (201) 200-8000

The Farm Credit System Insurance Corporation, which ensures the timely payment of principal and interest on insured securities issued by FCS banks, publishes an annual report. Copies are available from:

Farm Credit System Insurance Corporation
1501 Farm Credit Drive
McLean, VA 22102
Telephone: (703) 883-4380

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

Copies Are Available From:
Office of Congressional and Public Affairs
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090
703.883.4056

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