FARM CREDIT ADMINISTRATION

1998 ANNUAL REPORT

FCA's Mission

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

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Chairman's Message

On May 27, 1998, the Farm Credit Administration (FCA or Agency) recognized its 65th Anniversary. We were established in 1933 to help farmers suffering from the economic stress of that period. Some 40,000 farmers applied for loan restructuring during the first few months of FCA's existence and were thus able to avoid foreclosure on their farms. Our mission has changed over the years, but we remain proud of our fine tradition of service to American agriculture.

My fellow Board Members and I believe that the Farm Credit System (FCS or System) will play an important role for agriculture and rural America in the new millenium. We also believe that FCA must provide a flexible regulatory environment that enables the System to meet rural America's changing demands for credit and other financial services within the authorities established by Congress.

In July, after considerable thought and study, the FCA Board adopted a Philosophy Statement on Intra-System Competition. This Statement will help guide our future policy and regulatory decisions. We hope to facilitate the evolution, increased efficiency, and continued relevancy of the FCS. We have received much support for the new philosophy, but we recognize that not everyone shares our vision of the future. We are convinced, however, that to better serve agriculture it is the right thing to do. We will implement the new philosophy in an orderly manner only after careful consideration of all issues and concerns.

By adopting a final regulation that increases the opportunities for financing institutions that are not part of the System to establish a funding relationship with the FCS, we took yet another step to improve the availability of credit to rural America. Farmers, ranchers, and other rural residents will now have even greater access to credit. This is a "win-win-win" situation for the borrowers, the System, and other financing institutions!

In August, we again requested the public's help to identify regulations and policies that are duplicative, ineffective, or impose burdens greater than the benefits received. While we have reduced regulatory burden and further streamlined operations, we did not compromise our ability to oversee the safety and soundness of System institutions.

The System's financial condition is the best it has ever been — solid profits, strong loan volume growth, improved loan portfolio quality, and higher capital levels. We recognize however, that stress is building in the agricultural economy due to lower prices for some commodities, adverse weather conditions, and a decline in the Asian economies that affects the demand for agricultural exports. If these conditions continue, all lending institutions will experience some deterioration. In anticipation of this, System institutions have enhanced their risk-bearing capacity. For our part, FCA is dedicated to identifying and addressing emerging risks to ensure the continued health of, and public confidence in, the FCS.

The Year 2000 (Y2K) technology problem has received a great deal of attention this year. For internal operations, we have identified for repair or replacement those systems that are non-compliant. Our efforts are on schedule. For rating System institutions, we adopted the Y2K rating system of the Federal Financial Institutions Examination Council. We are closely monitoring the System's efforts and believe the institutions are making good progress in resolving the Y2K problem.

On October 18, 1998, we said goodbye to Board Member Doyle L. Cook, whose term had expired. His extensive experience, knowledge, and skill in agricultural lending and finance will be missed. Board Member Ann Jorgensen and I welcomed Michael M. Reyna to the Board on October 26. He brings a strong background in loan portfolio management and finance to the FCA Board. He is a valuable addition and we look forward to working together.

I commend our dedicated and skilled employees for improving customer service and enhancing communication with System institutions through our examination process and special communication programs. I remain confident that FCA will provide strong, effective oversight and regulation to keep the System financially sound during this period of change.

Marsha Pyle Martin
Chairman and Chief Executive Officer
December 1, 1998

Overview of Organizations

Farm Credit Administration

The Farm Credit Administration, 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. 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 supervisory 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.

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 she 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 banks' 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 named to the Academy of Honor in Agriculture by the FCB of Texas Board of Directors in recognition of her contributions to agriculture and farm credit in Texas. 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.

Doyle L. Cook[1] was appointed to the FCA Board by President Clinton on October 5, 1994, for a term that expired 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, he served as president and chief executive officer of the FCB of Spokane, as an active participant on various committees of FCS banks, as a director of the Federal Agricultural Mortgage Corporation (Farmer Mac), and as a member of the

1. Doyle L. Cook resigned on October 18, 1998, having served from the end of his term until his successor was named. Michael M. Reyna was appointed his successor on October 22, 1998

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 coauthor of a producer's guide entitled *The Farmer's Guide to Total Resource Management* and is the author of a book, *Put Paperwork in Its Place.* She was honored as the Outstanding Young Woman for the State of Iowa in 1976 and was inducted into the Iowa Volunteer Hall of Fame in 1989. 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 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; directs a program of examination policy formulation; and manages the Agency's enforcement activities.

The **Office of General Counsel** provides the FCA Board and staff with legal 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, inspections, investigations, and the review of proposed legislation and regulations.

The **Office of Policy and Analysis**[2] develops regulations and policy statements in support of FCA's mission to implement applicable statutes and promote the safety and soundness of the FCS. It provides economic and risk analyses of factors affecting the FCS. It also manages the chartering, corporate approval, and other statutory and regulatory approval activities on behalf of the FCA Board, and manages the data collection activities from FCS institutions.

The **Office of Resources Management** provides Agency financial and administrative management services including strategic and performance planning, information and human resources.

The **Office of Secondary Market Oversight** uses examination, rulemaking, and general supervision, and may use 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 September 30, 1998.

Officials

Marsha Pyle Martin	Chairman and Chief Executive Officer
Floyd J. Fithian	Secretary to the Board
Eileen M. McMahon	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 and Analysis
Donald P. Clark	Director, Office of Resources Management
George D. Irwin[3]	Director, Office of Secondary Market Oversight

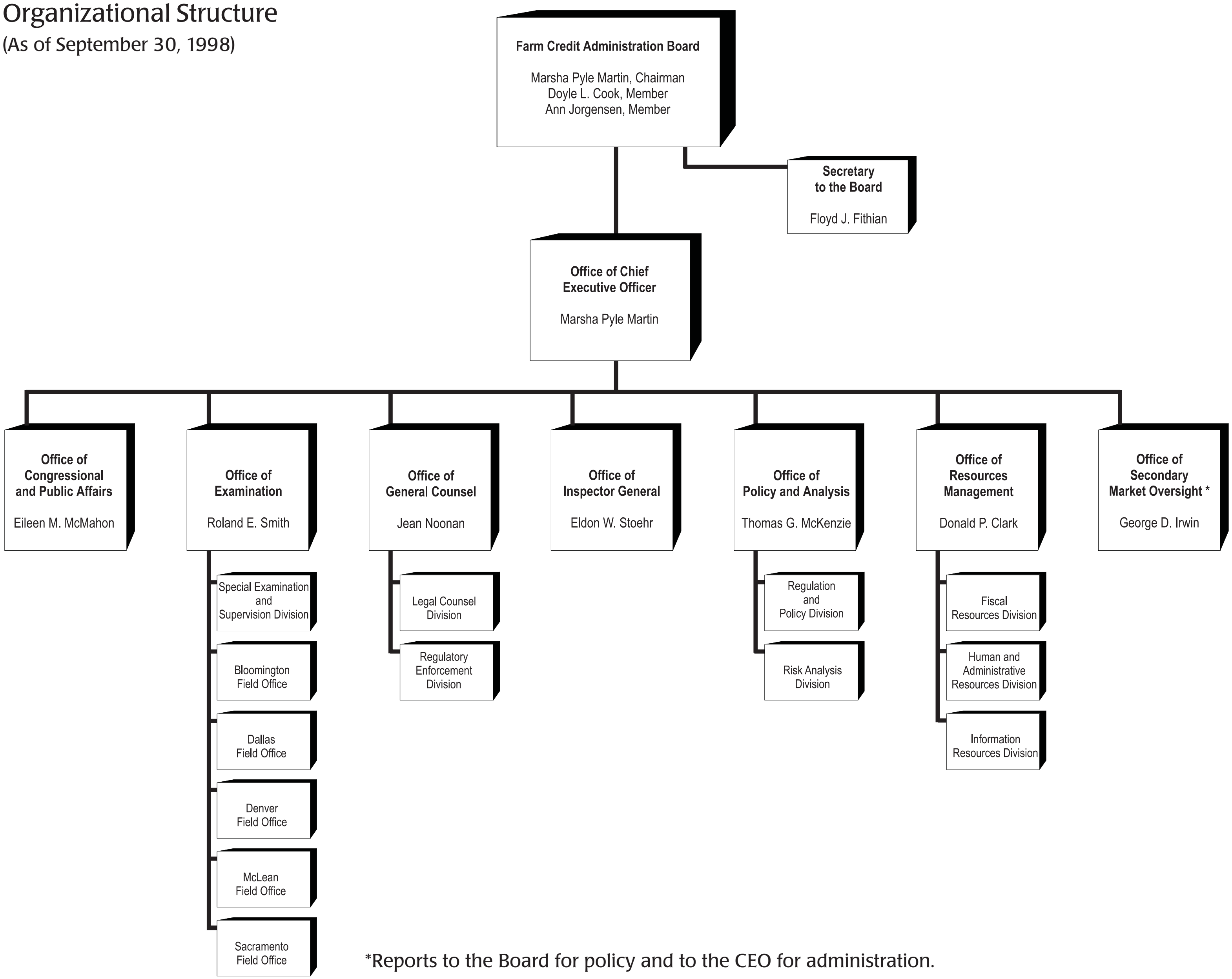
2. The Office of Policy and Analysis, formerly the Office of Policy Development and Risk Control, was reorganized and renamed, effective February 1, 1998.

3. Carl A. Clinefelter was named Acting Director, Office of Secondary Market Oversight, following the retirement of George D. Irwin on October 3, 1998. Larry W. Edwards served as Director, Office of Secondary Market Oversight, until his retirement on April 3, 1998.

Figure 1

Farm Credit Administration Organizational Structure

(As of September 30, 1998)



*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; agricultural, aquatic, and public utility cooperatives; and certain foreign and domestic entities in connection with international activities.

On October 1, 1998, there were 201 System banks and associations, consisting of:

- Six FCBs, which provide loan funds to 64 Production Credit Associations (PCAs), 53 ACAs, and 32 Federal Land Credit Associations (FLCAs) and make direct long-term real estate loans through 40 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 a BC and an FCB, providing loan funds to four ACAs. 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 was created to facilitate a secondary market for agricultural and rural housing mortgages. It guarantees the timely payment of principal and interest on securities representing interests in, or obligations backed by, mortgage loans secured by first liens on agricultural real estate or rural housing, and on securities backed by the "guaranteed portions" of farm ownership and operating loans, rural business and community development loans, and certain other loans guaranteed by the U.S. Department of Agriculture.

Service corporations organized under Section 4.25 of the Act also examined by FCA 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.

- 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 better meet its congressional mandate and the requirements of the Government Performance and Results Act of 1993 (Results Act). In fiscal year (FY) 1998, the FCA Board and senior management updated the Agency's Five-Year Strategic Plan. 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 mission is:

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

The FCA Board's vision is for the FCA to be the premier regulator of financial institutions, ensuring dependable credit for agriculture and rural America. In keeping with this vision, and to help guide operations, the Board adopted two strategic goals for FY 1998–2003:

1. Supervise risk in the Farm Credit System for the benefit of stakeholders.

2. Maximize opportunities for the Farm Credit System to provide competitive and dependable services for agriculture and rural America.

The Strategic Plan contains eight objectives designed to ensure that the goals are met.

During FY 1998, the FCA Board was successful in reducing both Agency costs and regulatory burden. Meeting the needs of customers without compromising the safety and soundness of the FCS continues to be a central focus of FCA's activities.

Reduction of regulatory burden continued during the year. FCA either eliminated, or proposed to eliminate, several prior-approval requirements. Regulatory burden was also reduced through the deletion of several obsolete regulatory provisions identified through internal Agency review or public comment. For the second time since 1993, FCA published a Notice of Intent with Request for Comments from its customers and the public.

In FY 1998, the FCA completed 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 operations, enhance efficiency and effectiveness, and share information among all headquarters and field staff. Along with implementing the client/server environment, the FCA has ensured that potential Year 2000 issues (see Glossary, page 46) 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 visited 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 progress of the Agency and the FCS in addressing Year 2000 problems. FCA testified at a hearing by the Senate Agriculture Committee on the Year 2000 issue on May 14, 1998, and since then has provided the committee with monthly status reports. FCA also provided testimony to the House and Senate Appropriations committees during the year regarding the Agency's budget request for FY 1999. The Agency requested a budget of $35.8 million, which was approved by the committees and subsequently by Congress and the President. The Agency also provided several congressional staff briefings during the year. These briefings were on the FCA Board's Philosophy Statement on Intra-System Competition and the progress and condition of the Federal Agricultural Mortgage Corporation. FCA responded to requests for information about its programs and operations and conducted 84 reviews based on inquiries concerning borrower rights.

The audit of the Agency's financial statements for the fiscal year ended September 30, 1998, received an unqualified opinion. The auditor reported no material weaknesses in the internal control structure of the Agency. However, the auditor's report on the Agency's compliance with laws and regulations disclosed one instance of noncompliance with the reporting requirements of the Prompt Pay Act. The auditor reported noncompliance even though OMB had waived this requirement for FCA described on page 28. It should be noted that the Prompt Pay Act reporting requirement was repealed on November 10, 1998, by Public Law 105-362.

The Agency's financial accomplishments in FY 1998 include the following:

- Continued to exercise effective controls over spending. The Agency's actual costs of $32.059 million for FY 1998 were $1.447 million below FY 1997 actual costs of $33.506 million.

- Continued to save occupancy costs through consolidation of space and housing FCA in the System-owned Farm Credit Building in McLean, Virginia. During FY 1998, FCA released 5,500 square feet of space for leasing, which will generate an estimated additional $220,000 a year in income. In addition, FCA's occupancy costs during 1998 were $5.40 per square foot, substantially below the average rental rates for similar office space in Northern Virginia ($25.00) and Washington, D.C. ($38.50).

- Applied $3.4 million to reduce the FY 1999 assessments of the FCS institutions. The $3.4 million includes assessments in excess of obligations from prior years and the Agency's earned interest and miscellaneous income in FY 1998.

Performance Measures

In FY 1998, the Agency refined its first Annual Performance Plan (APP), covering FY 1999 and 2000, in accordance with the Results Act. The APP lists the performance measures and goals for FCA's operations. The performance measures are contained in the FCA Strategic Plan for FY 1998–2003, which is available on FCA's Web site 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, Objectives, and Initiatives, assess the Agency's ultimate effectiveness in ensuring the safe and sound operation of the FCS.

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. Performance measurements have been linked to the performance standards for all professional staff. These measurements will be evaluated at both the mid-term and annual performance reviews with staff members.

Philosophy Statement

On July 14, 1998, the FCA Board adopted a Philosophy Statement on Intra-System Competition. The statement recognizes the dramatic changes the Farm Credit System has undergone in the past 25 years and the need for strategic change for the System to remain a relevant financial service provider in the 21st century. It affirms the FCA Board's belief that competition within the System is beneficial for the customer and the System. It also provides a framework for the FCA Board's future policy and regulatory decisions as the Board works to facilitate the further evolution, increased efficiency, and competitiveness of the System.

Specifically, the Philosophy Statement supports:

- Flexibility for associations to choose their source of funding.
- Initiatives brought to FCA by the System which will allow institutions to become more efficient and relevant in the marketplace.
- Removal of geographical boundaries of System entities.
- Movement toward institutional structures, which have broad-based lending authorities encompassing titles I, II, and III of the Farm Credit Act of 1971, as amended.
- Broad interpretation of existing statutes which will enable FCS institutions to become more competitive and, in the absence of statutory authority, considering legislative solutions.

Regulations and Policy Statements

The FCA has statutory and regulatory authority to establish policy and interpret the Farm Credit Act of 1971, as amended. As such, the Agency promulgates policy statements and regulations to ensure that the Farm Credit System 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 1998 was an active regulatory year for the Agency. Following are brief summaries of the final and proposed regulations and policy statements adopted by the FCA Board.

Final Regulations

Book-Entry Farm Credit Securities — On December 20, 1996, interim regulations were published that completely revised 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 the 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 enterprises, the FCA's interim rule was made effective on January 1, 1997, the date on which Treasury's new book-entry regulations became effective. The FCA took this coordinated action to avoid market uncertainty and help ensure a consistent regulatory approach for all users of the Book-entry System, including FCS 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 January 27, 1998)

Loan Sales Relief — The FCA Board adopted a direct final rule amending its regulations relating to loan sales into a secondary market. This action conformed FCA regulations to statutory amendments to the Farm Credit Act of 1971 made by sections 206 and 208 of the Farm Credit System Reform Act of 1996. These amendments provide that loans designated by FCS institutions for sale into a secondary market are not subject to minimum stock purchase or borrower rights requirements. (Adopted November 13, 1997; published December 2, 1997 [62 FR 63644]; effective March 4, 1998)

BC Loan Discounting — The FCA Board issued a direct final rule amending its regulations concerning interest rates and charges. This action is consistent with the FCA's continuing efforts to reduce regulatory burden and unnecessary prior approval requirements whenever possible. The amendments eliminated the prior approval requirement for changes in interest rate policies at Banks for Cooperatives, eliminated unnecessary or duplicative regulatory requirements, and clarified existing requirements that are retained. The effects of the amendments are to enable BCs to revise rate policies for discounting negotiable paper without prior FCA approval, to eliminate the requirement that fees charged by an association are subject to bank approval, and to clarify that, in all Farm Credit System banks and direct lender institutions, the board of directors is responsible for setting interest rates and annually reviewing interest rate plans in conjunction with the review and approval of the institution's annual business plan. (Adopted December 11, 1997; published December 22, 1997 [62 FR 66816]; effective March 4, 1998)

General Financing Agreement (GFA) — The FCA Board adopted a final rule amending its regulation that governs the funding relationship between a Farm Credit Bank or Agricultural Credit Bank and a direct lender association or other financing institution (OFI). This rule repealed the requirement that the FCA give prior approval to the GFA between an FCB or ACB and a direct lender association or OFI and eliminated a regulatory direct loan limitation. The rule also amended another regulation to permit the voluntary liquidation of Farm Credit institutions by means of an FCA-approved liquidation plan. (Adopted January 27, 1998; published February 4, 1998 [63 FR 5721]; effective March 13, 1998)

Assessment Technical Change — The FCA Board issued a direct final rule that made technical amendments to its assessment regulations to conform to the FCA Board policy statement on its Financial Institution Rating System (FIRS). The technical amendments did not substantively change the assessment process. The FIRS is the rating system used by FCA examiners for evaluating and categorizing the safety and soundness of Farm Credit System institutions on an ongoing, uniform, and comprehensive basis. The FIRS modified the FCA Rating System (which had been called the CAMEL rating system, referring to the following five rating components: capital, asset quality, management, earnings, and liquidity) by adding a sixth rating factor for sensitivity to market risk. In accordance with the FIRS policy statement, these technical amendments replace the reference to "composite CAMEL rating" with "composite Financial Institution Rating System (FIRS) rating" and replace references to "CAMEL" with "FIRS." (Adopted June 11, 1998; published June 24, 1998 [63 FR 34267]; effective August 3, 1998)

Other Financing Institutions — The FCA Board adopted a final rule amending its regulations that govern the funding and discount relationship between Farm Credit System banks that operate under title I of the Farm Credit Act of 1971 and OFIs. The final rule substantially expands access to System funding so that OFIs can provide more short- and intermediate-term credit to parties who are eligible to borrow under sections 2.4(a) and (b) of the Act. The FCA has repealed several non-statutory limits on OFI eligibility. The final rule assures access to any creditworthy OFI that is significantly involved in agricultural lending and demonstrates a continuing need for funds to serve its agricultural borrowers. Under certain circumstances, OFIs may seek financing from a Farm Credit Bank or Agricultural Credit Bank other than the System bank that is chartered to serve its territory. The final rule requires FCBs and ACBs to finance OFIs only on a fully secured basis and to have full recourse to the OFIs' capital. (Adopted June 11, 1998; published July 7, 1998 [63 FR 36541]; effective August 6, 1998)

Capital (Phase III) — The FCA Board adopted a final rule to amend its capital adequacy and related regulations to address interest rate risk; the grounds for appointing a conservator or receiver; capital and bylaw requirements for service corporations; and various computational issues and other issues involving the capital regulations. The rule adds safety and soundness requirements deferred from prior rulemakings, provides greater consistency with capital requirements of other financial regulators, and makes technical corrections. (Adopted July 14, 1998; published July 22, 1998 [63 FR 39219]; effective September 14, 1998)

Proposed Regulations

Balloting and Stockholder Reconsideration Issues — The FCA Board proposes to amend its regulations concerning Farm Credit System ballots and the effective dates for mergers, consolidations, or transfers of direct lending authority from a Farm Credit Bank or Agricultural Credit Bank to a Federal Land Bank Association. The proposed amendments would allow the use of identity codes on ballots, as long as the votes are tabulated by an independent third party, and would conform the scope of the regulation to statutory requirements. The amendments would also reduce the earliest effective date of a merger, consolidation, or transfer of lending authority from 50 days to 35 days after stockholder notification, or 15 days after submission of documents to the FCA for final approval, whichever occurs later. The effects of the amendments would be to provide more flexibility to institutions regarding the conduct of stockholder votes, to extend security and confidentiality requirements to all stockholder votes, and to accelerate the effective date of a merger, consolidation, or transfer of lending authority. (Adopted February 12, 1998; published March 20, 1998 [63 FR 13564])

Investment Management — The FCA Board proposes to amend the investment regulations to provide Farm Credit System banks with a broader array of eligible investments. Under the proposed regulations, FCS banks could hold only high-quality and liquid investments to maintain a liquidity reserve, could invest surplus funds, and could take steps to manage interest rate risk. The proposal would strengthen risk management practices at FCS banks and grant FCS banks greater flexibility to manage risk on an institutional, portfolio, or individual instrument level. These amendments are also designed to better enable FCS banks to adjust to the rapid and continual changes in the financial markets. (Adopted May 14, 1998; published June 18, 1998 [63 FR 33281])

Statement on Regulatory Burden — The FCA Board is requesting commenters to identify regulations and policies that duplicate other requirements, are ineffective, or impose burdens that are greater than the benefits received. This action is being taken to improve the regulatory framework within which the Farm Credit System operates. (Adopted August 11, 1998; published August 18, 1998 [63 FR 44176])

FCS Board Compensation Limits — The FCA Board proposes to amend its regulation on Farm Credit System bank director compensation. The proposed amendment, in accordance with waiver provisions of the Farm Credit Act of 1971, would authorize FCS banks to pay their directors more than the statutory maximum when justified by exceptional circumstances and would remove the existing requirement that such payments receive FCA's prior approval. (Adopted August 11, 1998; published September 15, 1998 [63 FR 49305])

Leasing Authorities — The FCA Board proposes leasing regulations to provide FCS 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]) After considering the comment letters received, the FCA revised the proposed rule and sought additional comment. The FCA Board issued a reproposed rule addressing the comments received on the proposed rule and streamlining the regulations where appropriate. The reproposed rule is intended to provide clear and concise regulations pertaining to the System's leasing activities and to clarify existing regulations that apply to leasing. (Adopted September 17, 1998; published October 23, 1998 [63 FR 56873])

FCA Board Policy Statements

Financial Institution Rating System — The FCA Board adopted a policy statement on the FIRS, the rating system to be used by FCA examiners for evaluating and categorizing the safety and soundness of Farm Credit System institutions on an ongoing, uniform, and comprehensive basis. The FIRS provides valuable information to the Agency for assessing risk and allocating resources based on the safety and soundness of regulated institutions. Ratings assigned to regulated institutions are adjusted periodically so that they accurately reflect the condition of institutions. (Adopted April 9, 1998; published April 22, 1998 [63 FR 19918])

Interest Rate Risk Management — The FCA Board issued for comment a proposed policy statement that provides guidance on interest rate risk management practices to FCS institutions and describes the Agency's approach to evaluating interest rate risk when making a determination of capital adequacy. The proposed policy statement identifies key elements of sound business principles and practices for interest rate risk management by an FCS institution. The policy statement also provides criteria by which the Agency will evaluate the adequacy and effectiveness of an FCS institution's interest rate risk management. (Adopted May 14, 1998; published May 21, 1998 [63 FR 27962])

Litigation

IBAA and ABA v. FCA

A decision is pending before the United States Court of Appeals for the District of Columbia Circuit on a Complaint for Declaratory and Injunctive Relief filed on April 9, 1997, by the Independent Bankers Association of America (IBAA) and the American Bankers Association (ABA). In the complaint, filed against FCA in the United States District Court for the District of Columbia, the plaintiffs challenged portions of FCA's new regulations governing eligibility and scope of Farm Credit System financing.

On November 24, 1997, the District Court found in FCA's favor, stating that the FCA "had acted well within its regulatory authority in each of the five sections in question." The plaintiffs filed an appeal on January 20, 1998, and on October 9, 1998, the Court of Appeals heard oral arguments from each of the parties.

Examination

The Farm Credit Administration's Office of Examination (OE) conducted 136 examinations in FY 1998. It examined 118 FCS direct lender institutions, 12 FLBAs, 3 FCS service corporations, Farmer Mac, and 2 non-FCS institutions, the National Consumer Cooperative Bank and the NCB Development Corporation.

Examinations are conducted according to risk-based examination practices whereby resources are deployed based on the level of risk in each institution. These risks are continuously identified, evaluated, and proactively addressed.

FCA's Financial Institution Rating System is similar to that used by other Federal banking regulators; however, it has been modified to reflect the nondepository nature of FCS institutions. The ratings are on a scale of 1 to 5, with a 5 designating the most severe regulatory concern. A 5 rating means there is an extremely high immediate or near-term probability of failure. A 3 rating means an institution exhibits a combination of financial management, operational, or compliance weaknesses ranging from unsatisfactory to moderately severe. A 1 rating means an institution is basically sound in every respect. As of the end of FY 1998, 98.5 percent of institutions were rated either 1 or 2. There were three 3-rated institutions, representing 1.5 percent of institutions rated. No institutions were rated 4 or 5.

The Agency continues to pursue means to enhance risk identification. An Early Warning System has been developed that identifies existing and prospective risk in FCS institutions. The Agency has also implemented a dynamic

FIRS benchmark program to identify changes in risk characteristics of institutions every 90 days. In addition, a financial forecasting model has been developed and implemented to identify and evaluate prospective risk in institutions over the next 12 to 24 months under "most likely" and "worst case" scenarios. These initiatives represent a proactive approach to identify institutions with emerging risks and potential for deterioration; evaluate the financial condition and performance under various scenarios; and employ differential supervision to address potential problems early. In the future, OE plans to enhance its modeling capabilities to include borrower loan information and external economic developments that may affect the financial condition of FCS institutions.

OE continues to focus on Year 2000 examination activities. Procedures are in place to assess each FCS institution's progress toward Year 2000 readiness. High-risk institutions have been identified early enough to enable examiners to monitor corrective actions implemented by those institutions. Each FCS institution is surveyed quarterly to measure progress toward achieving Year 2000 compliance.

During the latter part of the year, the Agency entered into an agreement with the Small Business Administration (SBA), under which FCA will conduct asset-based examinations, on a reimbursable basis, of the 14 Small Business Lending Companies that are licensed by the SBA and make SBA guaranteed loans throughout the country.

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 or remove officers, directors, and any other persons or prohibit them from participating in FCS institutions' affairs. If the FCA Board votes to take an enforcement action, the Special Examination and Supervision Division of the Office of Examination, in conjunction with OE Field Offices, oversees the performance of FCS institutions to ensure compliance.

The number of problem institutions and enforcement actions continued to decline during FY 1998. 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; it also reflects the healthy agricultural economy of the past few years. During FY 1998, no new enforcement actions were executed.

As a result of the improving financial and credit conditions of FCS institutions, coupled with satisfactory compliance with existing enforcement actions, the Agency terminated such actions on three institutions during FY 1998. At the end of FY 1997, five FCS institutions with aggregate assets of $2.9 billion were under some form of enforcement oversight.[4] At the end of FY 1998, one institution, which accounted for less than 5 percent of the System's assets, was under enforcement action. As of September 30, 1998, no institutions were in receivership or conservatorship.

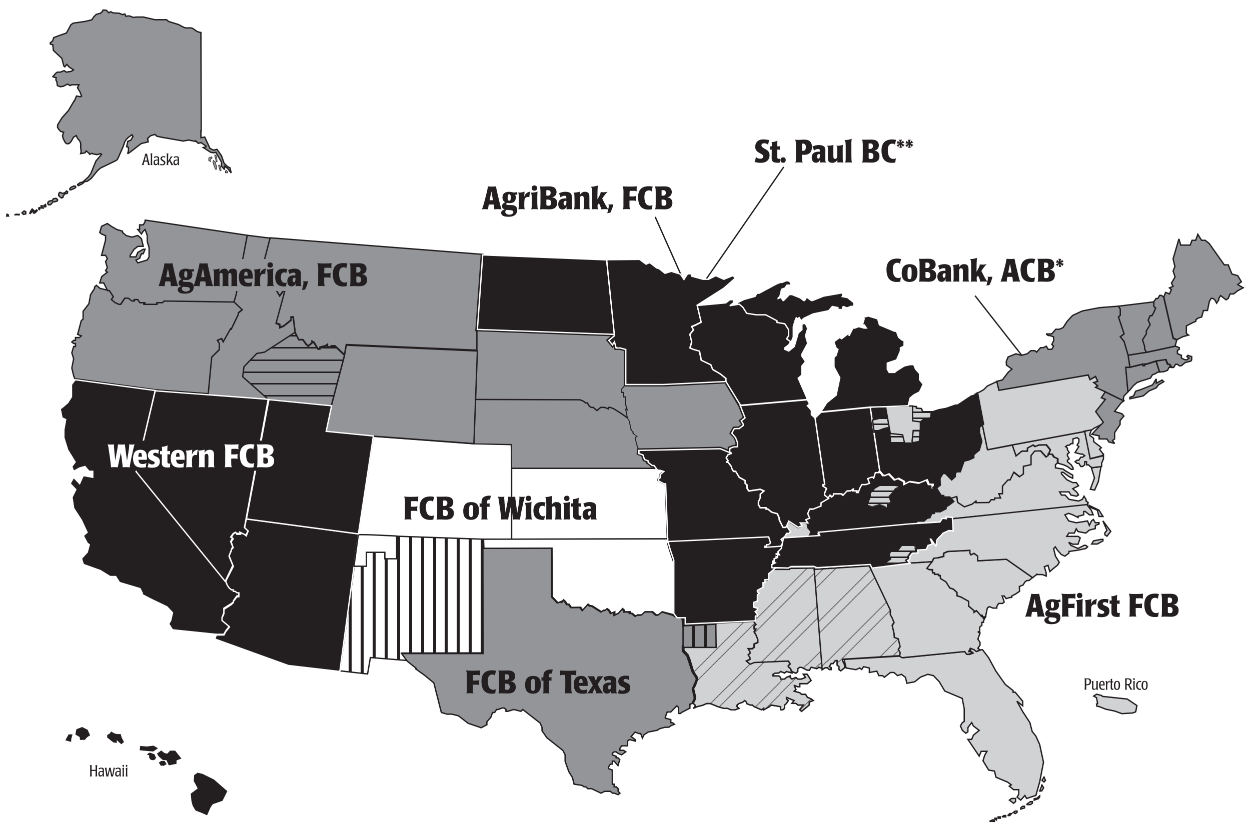
Corporate Activity

During FY 1998, the FCA Board approved 20 corporate applications, consisting of 11 association mergers, 1 association charter amendment for expansion of service territory, 1 association charter amendment for a headquarters relocation, 2 association name changes, 2 service corporation charter amendments, 1 proposal from a Farm Credit Bank to transfer authority to make long-term real estate mortgage loans to its affiliated Federal Land Bank Associations, and 2 requests from FLBAs to form Federal Land Credit Associations. Figure 2 on page 16 depicts the chartered territories of FCS banks.

In addition, the FCA Board approved the voluntary liquidation and canceled the charter of a service corporation that had been organized to provide information services to certain Farm Credit banks and associations.

4. One of the five was an institution under a supervisory letter. As of 1998, a supervisory letter is no longer classified as an enforcement action.

Figure 2
Farm Credit System Banks Chartered Territories
(As of October 1, 1998)



AgAmerica, FCB	Western FCB	FCB of Wichita	FCB of Texas	AgriBank, FCB	CoBank, ACB	AgFirst FCB
1 ACA	5 ACAs	20 FLBAs	20 FLBAs	9 ACAs	4 ACAs	38 ACAs
1 FLCA	11 FLCAs	2 FLCAs	16 PCAs	18 FLCAs		1 PCA
1 PCA	10 PCAs	18 PCAs		18 PCAs		

The PCA of New Mexico and the PCA of Eastern New Mexico are funded by the FCB of Texas. The PCA of Southern New Mexico 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 is headquartered in Denver, Colorado, and serves cooperatives nationwide and ACAs in the indicated area.

** The St. Paul BC is headquartered in St. Paul, Minnesota, and 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.

Audits, Inspections, and Investigations

During FY 1998, the Office of Inspector General (OIG) issued three audit reports — on FCA's Regulation Development Processes, FCA's Use of Enforcement Actions, and FCA's IMPAC (International Merchant Purchase Authorization Card) Program. The OIG also performed two field office inspections: the Bloomington Field Office and the Sacramento Field Office. An inspection of FCA's Workman's Compensation Program (administered by the U.S. Department of Labor) was also performed. In addition, the OIG contracted through the U.S. Department of Labor's Office of Inspector General with the independent accounting firm Tichenor and Associates to audit the financial statements for the fiscal year ended September 30, 1997. Tichenor and Associates is also engaged to audit the financial statements for the fiscal year ended September 30, 1998. The final audit report, included as part of this annual report, was issued on November 10, 1998.

Summaries of audit reports and inspections are published in the OIG's "Semiannual Report to the Congress." Copies of semiannual reports may be obtained from FCA's Office of Congressional and Public Affairs, 1501 Farm Credit Drive, McLean, VA 22102-5090; phone (703) 883-4056; fax (703) 790-3260; e-mail ***info-line@fca.gov*** or may be accessed on FCA's Web site at ***www.fca.gov***. OIG audit and inspection reports may be obtained by contacting the Office of Congressional and Public Affairs or the Office of Inspector General.

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

The 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. Four investigations were open at the beginning of FY 1998, one additional investigation was opened during the year, and three investigations were closed during the year, with the result that two remained open as of September 30, 1998. There were no criminal referrals or administrative actions following OIG investigations.

The OIG Hotline (1 (800) 437-7322, or (703) 883-4316 in the Washington, D.C., metropolitan area) is the primary vehicle used by Agency employees and the public to report fraud, waste, abuse, and mismanagement. 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. The OSMO provides for the examination and general supervision of Farmer Mac's safe and sound performance of its powers, functions, and duties. The statute prescribes that the OSMO be a separate office, reporting to the FCA Board, and that its activities, to the extent practicable, be carried out by individuals not responsible for the supervision of other FCS institutions.

The OSMO's activities include monitoring Farmer Mac's operations and providing for its annual examination. In 1998, the OSMO directed its attention to Farmer Mac's debt issuance strategy and nonmortgage investments as they relate to the achievement of Farmer Mac's mission; maintained compliance with a congressional request for the joint monitoring of Farmer Mac by the FCA and the Department of the Treasury; and continued the development of a risk-based capital regulation for Farmer Mac.

The director of the OSMO is required by statute to develop a risk-based capital regulation for Farmer Mac no sooner than the expiration of the 3-year period beginning on the date of enactment of the Farm Credit System Reform Act of 1996. This 3-year period expires on February 10, 1999. A proposed risk-based capital regulation is under development. Once approved by the FCA Board, it will be published in the *Federal Register* for public comment. This is planned to occur in 1999.

In conjunction with the development of this regulation, the FCA published for public comment a study entitled *Risk-Based Capital Regulations for Farmer Mac: Loan Loss Estimation Procedures*. The study estimates the historical loss experience on agricultural real estate loans meeting Farmer Mac's eligibility criteria and represents one step in the development of a risk-based capital regulation for Farmer Mac. (Adopted July 23, 1998; published July 28, 1998 [63 FR 40282])

Farm Credit Administration Annual Financial Report

September 30, 1998

Farm Credit Administration

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

FCA
FARM CREDIT ADMINISTRATION

November 30, 1998

The Honorable Marsha Pyle Martin
Chairman of the Board
Farm Credit Administration
1501 Farm Credit Drive
McLean, Virginia 22102-5090

Dear Ms. Martin:

This report presents the opinion on the Farm Credit Administration's (FCA) principal statements for the fiscal year ended September 30, 1998. 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. To fulfill our audit responsibilities under Government Auditing Standards and FCA PPM 100 for ensuring the quality of audit work performed, we monitored the progress of the audit, reviewed supporting workpapers, and performed other procedures deemed necessary to ensure compliance with Government Auditing Standards.

In Tichenor & Associates' opinion, FCA's principal statements present fairly, in all material respects, the financial position of FCA as of September 30, 1998, in conformity with Statements of Federal Financial Accounting Standards and related concepts.

The Tichenor & Associates report on internal control structure disclosed no material weaknesses in internal controls; however, it did disclose conditions existing during fiscal year 1998 which were considered to be reportable. Specifically, the auditors reported that 1) procedures are inadequate for detecting manipulation of financial statement information, and 2) controls over the payroll audit function are inadequate.

The Tichenor & Associates report on compliance with laws and regulations disclosed no instances of noncompliance with other laws and regulations except for an annual reporting requirement under the Prompt Pay Act, which was subsequently repealed by Public Law 105-362 on November 10, 1998.

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 this audit, Tichenor & Associates identified other matters, which are not reportable but nevertheless warrant management's attention. These matters 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 Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, Statement of Budgetary Resources, and Statement of Financing as of September 30, 1998. Amounts that 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 provided to the FCA Board.

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

In the opinion of management, the financial statements present fairly the financial position of FCA at September 30, 1998, in conformity with statements of Federal financial accounting concepts and standards.

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

Bruce E. Ward, Director
Fiscal Resources Division
and Deputy Chief Financial Officer

Overview

Mission and Organizational Structure

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

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

The System is a nationwide network of borrower-owned lending institutions and specialized service organizations. The System raises its funds as a Government-sponsored enterprise, however, the bonds issued by the System are not guaranteed by the United States Government. System institutions consist of Farm Credit Banks, related associations, one Bank for Cooperatives, one Agricultural Credit Bank 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. These credit facilities are pledged as collateral for the bonds issued by the System.

FCA operates under authorities conferred by the Act. The operations of FCA are financed by means of a revolving fund. This fund is reimbursed primarily from assessments received from the System institutions examined by FCA. Institutions are assessed or otherwise charged directly and billed in accordance with a formula established by FCA regulations. Assessments and other income earned in excess of obligations are taken into consideration in determining the amount to assess System institutions in the subsequent fiscal year. All of FCA's administrative expenses are paid by the institutions it examines, regulates, or for which it provides reimbursable services. The Congress has historically imposed a limitation on the amount of obligations that may be incurred in the fund in a given fiscal year. The limitation imposed for fiscal year 1998 was $34,423,000.

Performance Goals and Results

As presented in the FCA Strategic Plan, the Agency believes that the FCS will continue to play an important role in agriculture in the next century. FCA will continue to provide a regulatory environment that enables the System to meet rural America's changing demands for credit and other financial services within the authorities established by Congress. In doing so, the primary focus of the Agency is to ensure the long-term safety and soundness of the FCS and develop rules and policies that respect market forces. These commitments are captured in the Agency's mission statement:

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

To carry out this mission, the principles of customer service, product quality, effective operations, and clear communication are at the heart of the Agency's operating philosophy. These principles are consistent with the objectives of the Government Performance and Results Act of 1993 (Results Act), which encourages organizations to

manage for results and holds management accountable for executing programs to achieve desired outcomes.
To measure how effectively the Agency is fulfilling its mission, the FCA Board and executive management identified the following four key outcomes that directly link to the Agency's mission, functions, and strategic goals: (1) Effective Risk Identification and Corrective Action; (2) Effective Regulation and Public Policy; (3) Effective and Efficient Agency Administration; and (4) Effective External Relationships.

These outcomes provide for a thorough and balanced system of measures that support the two Agency functions: (1) Identifying Risk and Taking Corrective Action; and (2) Promulgating Regulations and Public Policy.

The Agency's performance is discussed in other parts of this annual report.

Changes in Accounting Principles and Presentation

With the enactment of the Chief Financial Officers (CFOs) Act of 1990, as amended, Congress called for the production of financial statements that fully disclose a Federal entity's financial position and results of operations and provide information not only for the effective allocation of resources but also provide information with which Congress, agency managers, the public, and others can assess management performance and stewardship. The Office of Management and Budget (OMB), in consultation with the CFO Council, the President's Council on Integrity and Efficiency, and other interested parties, developed formats and instructions for standard financial statements that would meet these objectives and published them in OMB Bulletin 97-01, *Form and Content of Agency Financial Statements.*

In October 1990 the Department of the Treasury, OMB, and the General Accounting Office (GAO), established the nine-member Federal Accounting Standards Advisory Board (FASAB). The FASAB was created to consider and recommend accounting principles for the Federal Government. These accounting principles include the concepts and standards contained in the Statements of Federal Financial Accounting Concepts (SFFAC) and Statements of Federal Financial Accounting Standards (SFFAS) recommended by the FASAB and issued by OMB. These concepts and standards were incorporated into OMB Bulletin 97-01 along with the formats and instructions for the development of standard financial statements.

The CFO Act required only certain Federal agencies to produce financial statements and have them audited. FCA was not one of the agencies mandated to comply with the CFO Act, however, Agency management elected to voluntarily do so. Voluntary compliance requires adherence to OMB Bulletin 97-01 and the related Federal accounting concepts and standards. Accordingly, the financial statements for FY 1998 are prepared in accordance with Federal accounting standards and concepts rather than generally accepted accounting principles (GAAP). The presentation of the statements is significantly different from prior years. Because this is the first fiscal year for production of financial statements under these criteria, there is no prior year comparative information. The Statement of Custodial Activity contained in OMB Bulletin 97-01 is not included with these financial statements because it is not applicable to FCA.

Limitations of the Financial Statements

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

- While the statements have been prepared from the books and records of FCA in accordance with the formats prescribed by OMB, the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records.

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

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CERTIFIED PUBLIC ACCOUNTANTS and MANAGEMENT CONSULTANTS

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INDEPENDENT AUDITOR'S REPORT ON THE FINANCIAL STATEMENTS

FARM CREDIT ADMINISTRATION
The Board and Office of Inspector General

We have audited the Principal Statements, which include the balance sheet, and the related statements of net cost, changes in net position, budgetary resources and financing of the Farm Credit Administration (FCA) for the year ended September 30, 1998, collectively referred to as the financial statements. 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.

We conducted our audit in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and, Office of Management and Budget (OMB) Bulletin 98-08, "Audit Requirements for Federal Financial Statements." 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.

As described in Note 1, FCA prepares its financial statements in conformity with the hierarchy of accounting principles and standards approved by the principals of the Federal Accounting Standards Advisory Board. The hierarchy is a comprehensive basis of accounting other than generally accepted accounting principles.

In our opinion, FCA's principal financial statements as of September 30, 1998, referred to above are fairly presented, in all material respects, in conformity with the basis of accounting described in Note 1. B. to the financial statements.

In accordance with Government Auditing Standards and OMB Bulletin 98-08, we have also issued a report dated November 10, 1998, on our consideration of the Farm Credit Administration's internal control structure and a report also dated November 10, 1998, on its compliance with laws and regulations.

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

TICHENOR & ASSOCIATES
Woodbridge, Virginia
November 10, 1998

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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 Principal Statements (hereinafter referred to as "financial statements") of the Farm Credit Administration (FCA) for the year ended September 30, 1998, and have issued our report thereon dated November 10, 1998. We conducted our audit in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and, Office of Management and Budget (OMB) Bulletin No. 98-08, "Audit Requirements for Federal Financial Statements."

In planning and performing our audit, we considered FCA's internal control over financial reporting by obtaining an understanding of the agency's internal controls, determined whether these internal controls had been placed in operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Consequently, we do not provide an opinion on internal controls.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the agency's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted two certain matters we consider to be reportable conditions. However, none of the reportable conditions are believed to be a material weakness. The reportable conditions we noted are as follows:

Inadequate procedures for detecting manipulation of financial statement information

Currently, the Farm Credit Administration can not print accounting and financial reports directly from its GLOWS accounting system. Files must be downloaded and then printed out of DOS or as text files. The files are then manipulated for formatting purposes using word processing or spreadsheet programs. Management has not implemented a control to mitigate the possibility of changes being made to the downloaded financial information before it is printed.

We recommend that procedures be developed to assure that the printed accounting reports tie to the financial information recorded in the GLOWS accounting system. In addition, we recommend that management require reconciliations of accounting records to the GLOWS system, and implement a policy that periodic reconciliations be performed by an employee who is not involved in the GLOWS data entry process.

Inadequate controls over the payroll audit function

The Personnel/Payroll and Transactions Branch (PPTB) System Assistant processes payroll and has access to the time records during the conversion process from ATTS to the PC Tare System. This assistant is able to change the type of time charged (i.e. leave without pay to regular time) but not the total hours. As a mitigating control, FCA has implemented a policy to audit the leave reports. These audits should detect any changes that may have occurred. However, the same PPTB System Assistant who performs the data entry and conversion to the PC Tare System is also the PPTB System Assistant that performs these leave report audits. Therefore, the leave audit as it is currently implemented does not provide an adequate mitigating control.

We recommend that FCA segregate the time entry and conversion functions from the payroll leave audit functions. The function of auditing payroll leave after the conversion from the ATTS to the PC Tare System should be assigned to an individual who is not authorized to enter payroll into the ATTS System.

In addition, with respect to internal controls related to performance measures reported, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, as required by OMB Bulletin 98-08. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

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

TICHENOR & ASSOCIATES
Woodbridge, Virginia
November 10, 1998

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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 Principal Statements (hereinafter referred to as "financial statements") of the Farm Credit Administration (FCA) for the year ended September 30, 1998, and have issued our report thereon dated November 10, 1998. We conducted our audit in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and, Office of Management and Budget (OMB) Bulletin No. 98-08, "Audit Requirements for Federal Financial Statements."

The management of FCA is responsible for complying with laws and regulations applicable to the agency. As part of obtaining reasonable assurance about whether the agency's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts and certain other laws and regulations specified in OMB Bulletin 98-08, including the requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996.

The results of our tests of compliance with the laws and regulations described in the preceding paragraph exclusive of FFMIA[1] disclosed an instance of noncompliance with the following law required to be reported under Government Auditing Standards and OMB Bulletin 98-08, as described below.

> Under the reporting requirements of the Prompt Pay Act, all Federal agencies must report annually to the Director of OMB by November 30th of each year. FCA received guidance from the Chief of the Agricultural Branch at OMB that FCA is not required to comply with the Prompt Pay Act reporting requirements because of the low dollar amount involved. However, there is no provision in the Act that gives OMB the authority to exempt an agency from complying with the Prompt Pay Act based on materiality. Based on the guidance received, FCA did not file the required Prompt Pay report to OMB. Therefore, we determined that FCA is not in compliance with the reporting requirements of the Prompt Pay Act because FCA did not submit its annual report for fiscal year ending September 30, 1997 by November 30, 1997. However it should be noted that on November 10, 1998, Public Law 105-362 repealed the Prompt Pay reporting requirement.

The results of our tests of compliance disclosed no instances of noncompliance with other laws and regulations except as discussed in the preceding paragraph and exclusive of FFMIA that are required to be reported under Government Auditing Standards or OMB Bulletin 98-08.

1. FFMIA does not impose any compliance requirements; rather, it requires reporting on whether any agency's financial management systems substantially comply with the financial management systems requirements contained in governmentwide policies, e.g., OMB Circular A-127, "Financial Management Systems;" Statements of Federal Financial Accounting Standards; and the United States Government Standard General Ledger published by the Department of the Treasury. FFMIA imposes additional reporting requirements when tests disclose instances in which agency systems do not substantially comply with the foregoing requirements.

Under FFMIA, we are required to report whether the agency's financial management systems substantially comply with the Federal financial management systems requirements, Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance using the implementation guidance for FFMIA included in Appendix D of OMB Bulletin 98-08.

The results of our tests disclosed no instances in which the agency's financial management systems did not substantially comply with the requirements discussed in the preceding paragraph.

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

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

TICHENOR & ASSOCIATES
Woodbridge, Virginia
November 10, 1998

FARM CREDIT ADMINISTRATION
BALANCE SHEET
As of September 30, 1998

ASSETS	
Intragovernmental	
Fund balance With Treasury (Note 2)	$ 451,653
Investments (Note 4)	16,477,079
Accounts receivable, net (Note 5)	74,308
Interest receivable	187,765
Prepaid expenses (Note 6)	3,540
Governmental	
Accounts receivable, net (Note 5)	109,335
Cash and other monetary assets (Note 3)	6,065
General property and equipment, net (Note 7)	190,008
Prepaid expenses (Note 6)	46,758
Total Assets	$17,546,511
LIABILITIES	
Intragovernmental liabilities:	
Accounts payable (Note 8)	$ 6,472
Other intragovernmental liabilities (Note 8)	4,046
Governmental Liabilities:	
Accounts payable (Note 8)	312,552
Other governmental liabilities (Note 8)	8,461,905
Total Liabilities	$ 8,784,975
NET POSITION	
Unexpended Appropriations (Note 11)	$ 8,761,536
Total Net Position	8,761,536
Total Liabilities and Net Position	$17,546,511

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

FARM CREDIT ADMINISTRATION
STATEMENT OF NET COST
For the year ended September 30, 1998

COSTS:		
Risk Segment:	$33,668,672	
Less earned revenues	(30,594,712)	
Net program costs		$3,073,960
Policy segment:	5,746,300	
Less earned revenues	(5,221,661)	
Net program costs		524,639
Reimbursable segment:	146,637	
Less earned revenues	(146,637)	
Net program costs		0
NET COST OF OPERATIONS		$3,598,599

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

FARM CREDIT ADMINISTRATION
STATEMENT OF CHANGES IN NET POSITION
For the year ended September 30, 1998

Net Cost of Operations		$(3,598,599)
Financing Sources (other than exchange revenues):		
Imputed financing:		
Pensions and postretirement benefits (Note 9)	$1,507,274	
Rent (Note 12)	2,211,929	
Total imputed financing		3,719,203
Net Results of Operations		120,604
Prior Period Adjustments (Note 1)		6,664,186
Net Change in Cumulative Results of Operations		6,784,790
Change in Net Position		6,784,790
Net Position — Beginning of Period		1,976,746
Net Position — End of Period		$8,761,536

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

FARM CREDIT ADMINISTRATION
STATEMENT OF BUDGETARY RESOURCES
For the year ended September 30, 1998

Budgetary Resources:	
Unobligated balances — beginning of period	$ 8,894,445
Spending authority from offsetting collections	34,213,814
Total budgetary resources	$ 43,108,259
Status of Budgetary Resources:	
Obligations incurred	$ 31,652,166
Unobligated balances — available	7,085,508
Unobligated balances — not available	4,370,585
Total, status of budgetary resources	$ 43,108,259
Outlays:	
Obligations incurred	$ 31,652,166
Less: spending authority from offsetting collections and adjustments	(34,213,814)
Obligated balance, net — beginning of period	6,077,368
Less: obligated balance, net — end of period	(5,453,535)
Total outlays	$ (1,937,815)

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

FARM CREDIT ADMINISTRATION
STATEMENT OF FINANCING
For the year ended September 30, 1998

Obligations and Nonbudgetary Resources		
Obligations incurred	$31,652,166	
Less: Spending authority for offsetting collections and adjustments	(34,213,814)	
Financing imputed for cost subsidies (Notes 9 and 12)	3,719,203	
Exchange revenue not in the budget	2,140,326	
Total obligations as adjusted, and nonbudgetary resources		$3,297,881
Resources That Do Not Fund Net Cost of Operations		
Change in amount of goods, services, and benefits ordered but not yet received or provided	(96,890)	
Costs capitalized in the balance sheet	(18,684)	
Other	65,870	
Total resources that do not fund net cost of operations		(49,704)
Costs That Do Not Require Resources		
Depreciation and amortization		350,422
Net Cost of Operations		$3,598,599

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

NOTES TO THE FINANCIAL STATEMENTS

Note 1. Significant Accounting Policies:

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

B. Basis of accounting — The accompanying financial statements have been prepared in accordance with Statements of Federal Financial Accounting Standards (SFFAS) and related concepts. The preparation of financial statements in conformity with SFFAS 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.

The Chief Financial Officers Act of 1990 (CFO Act) required certain Federal agencies to develop financial statements that provide information useful to Congress, Government officials, and the public. FCA is not one of the Federal agencies mandated to adhere to the CFO Act, however, Agency management has voluntarily elected to have financial statements prepared and audited in accordance with this law. To comply with the CFO Act, the Agency's financial statements are presented in conformity with OMB Bulletin 97-01, *Form and Content of Agency Financial Statements.* This represents a fundamental change in presentation from generally accepted accounting principles (GAAP) in prior years. Fiscal year 1998 is the transition year and accordingly the financial statements do not contain comparative information.

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.

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 used to allocate the cost of capitalized property and equipment over estimated useful lives of three years.

Rent — The Act provides for FCA to occupy buildings and use land owned and leased by the FCS Building Association (FCSBA), an entity owned by System banks. FCA is not charged for the use of the buildings or land, owned or leased, nor does it pay for maintenance and repair of buildings and land improvements. See Note 12.

Pension and postretirement health and life insurance benefits — Each employing Federal agency is required to recognize its share of the Federal Government's cost and imputed financing for pension, postretirement health benefits, and life insurance. Cost 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.

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 average risk adjusted assets and the overall financial health of the institution being assessed.

Revenue recognition — Beginning in FY 1998, the Agency recognized revenue in accordance with SFFAS No. 7, *Accounting for Revenue and Other Financing Sources.* This is a change in accounting principle from previous years. Under SFFAS No. 7, the entire amount of assessment revenue was recognized ratably over the fiscal year. Deferred revenue reported in prior period financial statements was reclassified in accordance with SFFAS No. 7 to conform to current financial statement presentation.

Note 2. Fund Balance with Treasury:

Revolving Fund for Administrative Expenses	$ 451,653

Note 3. Cash and Other Monetary Assets:

Imprest Fund	$ 1,500
Flexible Spending Account	4,565
Total	$ 6,065

Miscellaneous income earned from the Flexible Spending Account in FY 1998 from the 1997 plan year was $1,249, net of $737 used to cover over-reimbursed accounts. Over-reimbursed accounts generally occur when an employee leaves the Agency having received more in reimbursements than he/she contributed to the plan. See Note 10.

Note 4. Investments:

	Amounts for Balance Sheet Reporting (1) Amortized Cost	(2) Unamortized (Premium) Discount	(3) Investments, Net	(4) Required Market Value Disclosure
Intragovernmental				
Securities:				
Non-Marketable:				
Market-Based	$16,477,079	$37,921	$16,515,000	$16,515,045

Premiums and discounts are amortized using the straight-line method (which approximates the interest method) over the term of the respective issues. Interest earned on investments was $884,345 for FY 1998.

Note 5. Accounts Receivable:

Assessments due from assessed institutions and Non-System entities:	$ 108,110
Related parties:	
FCS Insurance Corporation (FCSIC)	28,360
FCSBA	1,225
Miscellaneous other receivables	45,948
Total	$ 183,643

Note 6. Prepaid Expenses:

Intragovernmental	$ 3,540
Governmental	46,758
Total	$ 50,298

Note 7. General Property and Equipment:

Office equipment	$ 1,474,727
Less accumulated depreciation	(1,284,719)
Book value	$ 190,008
Depreciation expense	$ 350,422

Note 8. Other Liabilities:

Intragovernmental	
Accounts payable	$ 6,472
Other accrued expenses	4,046
Total	$ 10,518
Governmental	
Accounts payable	$ 312,552
Accrued payroll and benefits	1,392,626
Accrued annual leave	2,113,224
Other accrued expenses	585,470
Prepaid assessments	4,370,585
Total	$ 8,774,457

Prepaid assessments are first quarter FY 1999 assessment payments received before the due date of October 1, 1998.

Note 9. Pensions, Other Retirement Benefits, and Other Post-Employment Benefits:

Funded pension cost	$ 1,989,518
Imputed pension cost	805,039
Other imputed retirement benefits	702,235
Total	$ 3,496,792

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 plan, nor does it report actuarial data for accumulated plan benefits. The reporting of such amounts is the responsibility of OPM, but the pension expense of the Agency's employees is reported in accordance with SFFAS No. 5 (see Note 1). A corresponding amount of imputed revenue is recorded to offset the expense.

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

Note 10. 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 a 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. During FY 1998 FCA funded premiums for retirees that were not covered by the plan income. Participants have been notified that the plan will be modified on January 1, 1999, to eliminate the unbudgeted cost.

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.

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. This typically occurs when an employee leaves the Agency during the year and reimbursements paid to the employee exceed the amount of withholding the employee has contributed to the plan.

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

Note 11. Net Position:

Unobligated Balance (available)	$ 7,085,508
Undelivered orders	1,486,020
Fixed Assets	190,008
Net Position	$8,761,536

The unobligated balance available contains funds to maintain a reserve to cover claims, judgments, litigative awards, and other contingencies. The remainder of the unobligated balance is available for offset against the FY 1999 assessments.

Note 12. Rent:

Leased field offices	$ 827,687
FCA headquarters	1,384,242
Total	$ 2,211,929

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 market value of the facilities provided by FCSBA at no cost to FCA for FY 1998 was approximately $3.3 million.

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

Note 13. Budgetary Resources:

The Farm Credit Act of 1971, as amended, provides FCA with a permanent indefinite appropriation to pay the expenses of the Agency. 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 1998 was $34,423,000. During FY 1998, FCA had direct obligations of approximately $32,059,003 subject to the limitation. In addition, during FY 1998, FCA incurred obligations of approximately $146,637 related to reimbursable activities. Budgetary resources cover all liabilities of the Agency.

Note 14. 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 $146,637 for FY 1998. 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 12, 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 $430,453 for FY 1998. 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 Farm Credit Bank was formed on 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, AgAmerica and the Western FCB entered a joint management agreement. As a result of the agreement, AgAmerica moved its headquarters from Spokane, Washington, to Sacramento, California.

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

AgFirst Farm Credit Bank — This institution, headquartered in Columbia, South Carolina, 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 an association 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, headquartered in St. Paul, Minnesota, 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 or a Federal Land Credit Association and a Production Credit Association and has the combined authority of the two institutions. An ACA borrows funds from a Farm Credit Bank or Agricultural Credit Bank to provide short-, intermediate-, and long-term credit to farmers, ranchers, and producers 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 (Minnesota) BC is the only BC in the Farm Credit System.

BC — The acronym for Bank for Cooperatives.

C

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 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, 1998, there were six FCBs: AgAmerica, FCB; AgFirst Farm Credit Bank; AgriBank, FCB; Farm Credit Bank of Texas; Farm Credit Bank of Wichita; and Western Farm Credit Bank.

Farm Credit Bank of Texas — This institution, headquartered in Austin, Texas, 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 — This institution, headquartered in Wichita, Kansas, provides services and short-, intermediate-, and long-term financing to associations serving Colorado, Kansas, and Oklahoma, short- and intermediate-term financing to part of New Mexico, and long-term financing to New Mexico through its FLBA.

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

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

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

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

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

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

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, created by the Agricultural Credit Act of 1987, provides guarantees for the timely repayment of principal and interest on securities backed by agricultural real estate or rural housing loans, and on securities backed by the "guaranteed portions" of U.S. Department of Agriculture guaranteed 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 and examined by the FCA and is defined by statute as a Farm Credit System institution.

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

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

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

Federal Land Bank Association (FLBA) — FLBAs are lending agents for Farm Credit Banks. FLBAs make and service long-term mortgage loans to farmers and 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.

FLB — The acronym for Federal Land Bank.

FLBA — The acronym for Federal Land Bank Association.

FLCA — The acronym for Federal Land Credit 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.

O

OFI — The acronym for other financing institution.

Other Financing Institution — An other financing institution is defined as any national bank, State bank, trust company, agricultural credit corporation, incorporated livestock loan company, savings institution, credit union, or any association of agricultural producers engaged in the making of loans to farmers and ranchers, and any corporation engaged in the making of loans to producers or harvesters of aquatic products.

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 lend 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 — This institution, headquartered in Sacramento, California, provides loan funds and services to the associations serving Arizona, California, Hawaii, part of Idaho, Nevada, and Utah.

Y

Year 2000 (Y2K) — 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 may be found in the Farm Credit Administration annual *Report on the Financial Condition and Performance of the Farm Credit System* and the *Farm Credit Administration Mid-Year Report*. 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***

These publications and the *FCA Annual Report* are now available on FCA's Web site at ***http://www.fca.gov***.

The Federal Farm Credit Banks Funding Corporation prepares the financial press releases, the Farm Credit System Annual Report to Investors, the System's Annual and Quarterly Information Statements, and the System's combined financial statements contained therein, with the support of the System banks. The Funding Corporation's Web site is located at ***www.farmcredit-ffcb.com***. Copies of the publications are available for inspection at, or will be furnished, without charge, upon request to, the Funding Corporation.

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:
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McLean, VA 22102-5090
703.883.4056
http://www.fca.gov

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