

# **LEGACY AG CREDIT, ACA**

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## **2011 Quarterly Report Third Quarter**



**For the Quarter Ended September 30, 2011**

## REPORT OF MANAGEMENT

The undersigned certify that we have reviewed this report, that it has been prepared in accordance with all applicable statutory or regulatory requirements, and that the information contained herein is true, accurate and complete to the best of his or her knowledge and belief.



Greg Cunningham, Chief Executive Officer  
*November 3, 2011*



Jerry Cordell, Chairman, Board of Directors  
*November 3, 2011*



Wayne Bawcum, C.P.A., Chairman, Audit Committee  
*November 3, 2011*



Daryl D. Belt, Chief Financial Officer  
*November 3, 2011*

## **LEGACY AG CREDIT, ACA MANAGEMENT'S DISCUSSION AND ANALYSIS**

The following commentary reviews the financial performance of Legacy Ag Credit, ACA (Agricultural Credit Association), referred to as the Association, for the quarter and nine months ended September 30, 2011. These comments should be read in conjunction with the accompanying financial statements and the December 31, 2010 Annual Report to Stockholders.

The Association is a member of the Farm Credit System (System), a nationwide network of cooperatively owned financial institutions established by and subject to the provisions of the Farm Credit Act of 1971, as amended, and the regulations of the Farm Credit Administration (FCA) promulgated thereunder.

The consolidated financial statements comprise the operations of the ACA and its wholly-owned subsidiaries. The consolidated financial statements were prepared under the oversight of the Association's audit committee.

### **Significant Events:**

The Association underwent an examination by the Farm Credit Administration (FCA) in early 2009. As a result of this examination, an enforcement action (Supervisory Agreement) by the FCA was instituted against the Association in November 2009. The basis of the enforcement action was unsafe and unsound practices and conditions and violations of FCA regulations within the institution.

The Chief Executive Officer (CEO) and Chief Credit Officer (CCO) were terminated by the Association's Board of Directors (Board) in October 2009. An interim CEO was named in October of 2009 who served until the selection of a new CEO in September 2010. An interim CCO was named in September of 2010 who served until the selection of a new CCO in February 2011.

In March of 2011, a revised Supervisory Agreement was entered into between the FCA and the Association's Board which supersedes and terminates the November 2009 Supervisory Agreement. In general, the basis for the revised Supervisory Agreement was that the Board's actions and corrective action plans, although improving, have not yet resulted in a substantial improvement in the quality of the Institution's portfolio or the Institution's financial condition and performance. See Note 8 for additional information.

The Board and management are dedicated to meeting their obligation in complying with the revised agreement, and believe the actions taken to date and those that will be taken in the future will result in a safe and sound Association which will better meet the financing needs of its stockholders.

The primary source of liquidity and funding for the Association is a direct loan from the Farm Credit Bank of Texas (Bank). The indebtedness is collateralized by a pledge of substantially all of the Association's assets to the Bank and is governed by a general financing agreement (GFA). In addition to borrowing limits, the GFA establishes certain covenants including limits on leases, investments, other debt, and dividend and patronage distributions; minimum standards for return on assets, the ratio of adverse assets to risk funds and for liquidity; and provisions for conducting business, maintaining records, reporting financial information, and establishing policies and procedures. Remedies specified in the GFA associated with the covenants include additional reporting requirements, development of action plans, increases in interest rates on indebtedness, and reduction of lending limits or repayment of indebtedness. Beginning in 2009 and continuing through 2011, the Association was subject to remedies associated with the covenants in the GFA due to not achieving minimum standards for return on assets, liquidity and adversely classified assets to risk funds. The Bank issued limited waivers to the GFA for 2009, 2010 and 2011 related to not achieving these minimum standards, subject to the Association meeting other designated conditions. All other conditions/covenants of the financing agreement remain in full force and effect. It is management's opinion that compliance with the limited waivers issued for 2011 will be maintained for the foreseeable future.

### **Loan Portfolio:**

Total loans outstanding at September 30, 2011, including nonaccrual loans and sales contracts, were \$222,956,892 compared to \$250,449,194 at December 31, 2010, reflecting a decrease of 11.0 percent. Nonaccrual loans as a percentage of total loans outstanding were 13.9 percent at September 30, 2011, compared to 18.2 percent at December 31, 2010.

The Association recorded \$64,025 in recoveries and \$12,524 in charge-offs for the quarter ending September 30, 2011, and \$1,656 in recoveries and \$948,573 in charge-offs for the same period in 2010. The Association's allowance for loan losses was 4.2 percent and 4.2 percent of total loans outstanding as of September 30, 2011, and December 31, 2010, respectively.

Credit quality declined significantly in 2009 and has remained unsatisfactory into 2011. Poultry, dairy, alternative fuels and real estate concentrations of the loan portfolio are the most affected. The primary poultry integrator in the Association's territory

underwent reorganization beginning in late 2008 and continued into late 2009, which required a downgrade of the credit quality ranking of substantially all of the independent poultry grower loans in the portfolio. This situation has remained through 2011. Though these loans were current regarding contractual payments, the status of these poultry grower loans relies substantially upon the integrator for continued operations and cash flow. The Association has no direct credit relationships with the poultry integrator. The stress in the dairy business reflected a significant negative impact to the loan portfolio and earnings. In 2009, a number of the Association's large dairy relationships were determined to be distressed and placed into nonaccrual with associated reserves for potential losses. This credit risk has persisted into 2011 though the dairy concentration in the portfolio has been reduced significantly.

### Risk Exposure:

High-risk assets include nonaccrual loans, loans that are past due 90 days or more and still accruing interest, formally restructured loans and other property owned. The following table illustrates the Association's components and trends of high-risk assets.

	September 30, 2011		December 31, 2010	
	Amount	%	Amount	%
Nonaccrual	\$ 31,034,331	83.8%	\$ 45,659,610	92.3%
90 days past due and still accruing interest	208,241	0.6%	-	0.0%
Formally restructured	1,309,405	3.5%	-	0.0%
Other property owned, net	4,495,720	12.1%	3,808,889	7.7%
Total	<u>\$ 37,047,697</u>	<u>100.0%</u>	<u>\$ 49,468,499</u>	<u>100.0%</u>

### Results of Operations:

The Association had net losses of \$732,062 and \$332,447 for the three and nine months ended September 30, 2011, as compared to net losses of \$110,607 and \$1,420,445 for the same periods in 2010, respectively. Net interest income was \$4,694,505 for the nine months ended September 30, 2011, compared to \$4,916,761 for the same period in 2010. Interest income for the first nine months of 2011 decreased by \$1,392,228, or 12.8 percent, from the same period of 2010, primarily due to declines in average loan volume. Interest expense for the first nine months of 2011 decreased by \$1,169,972, or 19.8 percent, from the same period of 2010, again, primarily due to a decrease in average debt volume. Average loan volume for the third quarter of 2011 was \$226,675,362, compared to \$273,137,272 in the third quarter of 2010. The average spread on the loan portfolio for the third quarter of 2011 was 2.37 percent, compared to 1.37 percent in the third quarter of 2010.

The Association's return on average assets for the 9 months ended September 30, 2011, was -0.13 percent compared to -0.55 percent for the same period in 2010. The Association's return on average equity for the 9 months ended September 30, 2011, was -0.81 percent, compared to -3.53 percent for the same period in 2010.

### Liquidity and Funding Sources:

The Association secures the majority of its lendable funds from the Bank, which obtains its funds through the issuance of Systemwide obligations and with lendable equity. The following schedule summarizes the Association's borrowings.

	September 30,	December 31,
	2011	2010
Note payable to the Bank	\$ 186,195,601	\$ 212,404,963
Accrued interest on note payable	479,398	594,100
Total	<u>\$ 186,674,999</u>	<u>\$ 212,999,063</u>

The primary source of liquidity and funding for the Association is a direct loan from the Bank. The indebtedness is collateralized by a pledge of substantially all of the Association's assets to the Bank and is governed by a GFA. In addition to borrowing limits, the GFA establishes certain covenants including limits on leases, investments, other debt, and dividend and patronage distributions; minimum standards for return on assets, the ratio of adverse assets to risk funds and for liquidity; and provisions for conducting business, maintaining records, reporting financial information, and establishing policies and procedures. Remedies specified in the GFA associated with the covenants include additional reporting requirements, development of action plans, increases in interest rates on indebtedness, reduction of lending limits or repayment of indebtedness. Beginning in 2009 and continuing through 2011, the Association was subject to remedies associated with the covenants in the GFA due to not achieving minimum standards for return on assets, liquidity and adversely classified assets to risk funds. The Bank issued limited waivers to the GFA for 2009,

2010 and 2011 related to not achieving these minimum standards, subject to the Association meeting other designated conditions. All other conditions/covenants of the financing agreement remain in full force and effect. It is management's opinion that compliance with the limited waivers issued for 2011 will be maintained for the foreseeable future.

### **Capital Resources:**

The Association's capital position decreased by \$449,504 at September 30, 2011, compared to December 31, 2010. The Association's debt as a percentage of members' equity was 4.83:1 as of September 30, 2011, compared to 5.45:1 as of December 31, 2010.

Under regulations governing minimum permanent capital adequacy and other capitalization issues, the Association is required to maintain a minimum adjusted permanent capital of 7.0 percent of risk-adjusted assets as defined by the FCA. The Association's permanent capital ratio at September 30, 2011, was 15.5 percent, which is in compliance with the FCA's minimum permanent capital standard. The Association's core surplus ratio and total surplus ratio at September 30, 2011, were 15.0 and 15.0 percent, respectively, which is in compliance with the FCA's minimum surplus standard.

As of September 30, 2011, the Association is prohibited from distributing earnings without prior approval from the FCA due to the provisions of the Supervisory Agreement.

### **Significant Recent Accounting Pronouncements:**

In June 2011, the Financial Accounting Standards Board (FASB) issued guidance entitled, "Comprehensive Income – Presentation of Comprehensive Income." This guidance is intended to increase the prominence of other comprehensive income in financial statements. The current option that permits the presentation of other comprehensive income in the statement of changes in equity has been eliminated. The main provisions of the guidance provides that an entity that reports items of other comprehensive income has the option to present comprehensive income in either one or two consecutive financial statements:

- A single statement must present the components of net income and total net income, the components of other comprehensive income and total other comprehensive income, and a total for comprehensive income.
- In a two-statement approach, an entity must present the components of net income and total net income in the first statement. That statement must be immediately followed by a financial statement that presents the components of other comprehensive income, a total for other comprehensive income, and a total for comprehensive income.

This guidance is to be applied retrospectively and is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The adoption of this guidance will not impact financial condition or results of operations, but will result in changes to the presentation of comprehensive income.

In May 2011, the FASB issued guidance entitled, "Fair Value Measurement – Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRSs." The amendments change the wording used to describe the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. The amendments include the following:

1. Application of the highest and best use and valuation premise is only relevant when measuring the fair value of nonfinancial assets (does not apply to financial assets and liabilities).
2. Aligning the fair value measurement of instruments classified within an entity's shareholders' equity with the guidance for liabilities. As a result, an entity should measure the fair value of its own equity instruments from the perspective of a market participant that holds the instruments as assets.
3. Clarifying that a reporting entity should disclose quantitative information about the unobservable inputs used in a fair value measurement that is categorized within Level 3 of the fair value hierarchy.
4. An exception to the requirement for measuring fair value when a reporting entity manages its financial instruments on the basis of its net exposure, rather than its gross exposure, to those risks.
5. Clarifying that the application of premiums and discounts in a fair value measurement is related to the unit of account for the asset or liability being measured at fair value. Premiums or discounts related to size as a characteristic of the entity's holding (that is, a blockage factor) instead of as a characteristic of the asset or liability (for example, a control premium), are not permitted. A fair value measurement that is not a Level 1 measurement may include premiums or discounts other than blockage factors when market participants would incorporate the premium or discount into the measurement at the level of the unit of account specified in other guidance.
6. Expansion of the disclosures about fair value measurements. The most significant change will require entities, for their recurring Level 3 fair value measurements, to disclose quantitative information about unobservable inputs used, a description of the valuation processes used by the entity, and a qualitative discussion about the sensitivity of the

measurements. New disclosures are required about the use of a nonfinancial asset measured or disclosed at fair value if its use differs from its highest and best use. In addition, entities must report the level in the fair value hierarchy of assets and liabilities not recorded at fair value but where fair value is disclosed.

The amendments are to be applied prospectively. The amendments are effective during interim and annual periods beginning after December 15, 2011. Early application is not permitted.

In January 2011, the FASB issued guidance entitled, “Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings.” This guidance temporarily delayed the effective date of the disclosures about troubled debt restructurings required by the guidance previously issued on “Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses.” The effective date of the new disclosures about troubled debt restructurings (TDR) coincides with the guidance for determining what constitutes a TDR as described below.

In April 2011, the FASB issued its guidance entitled, “A Creditor’s Determination of Whether a Restructuring is a Troubled Debt Restructuring,” which provides for clarification on whether a restructuring constitutes a TDR. In evaluating whether a restructuring is a TDR, a creditor must separately conclude that both of the following exists: (1) the restructuring constitutes a concession, and (2) the debtor is experiencing financial difficulties. For nonpublic entities, the guidance is effective for annual periods ending on or after December 15, 2012, including interim periods within those annual periods. The Association is currently evaluating the impact of adoption of this Standard on the financial condition or results of operations. The adoption will result in additional disclosures.

In July 2010, the FASB issued guidance on “Disclosures about the Credit Quality of Financing Receivables and the Allowance for Loan Losses,” which is intended to provide additional information to assist financial statement users in assessing an entity’s credit risk exposures and evaluating the adequacy of the allowance for credit losses. Existing disclosures are amended to include additional disclosures of financing receivables on a disaggregated basis (by portfolio segment and class of financing receivable) including among others, a rollforward schedule of the allowance for credit losses from the beginning of the reporting period to the end of the period on a portfolio segment basis, with the ending balance further disaggregated on the basis of the method of impairment (individually or collectively evaluated). The guidance also calls for new disclosures including but not limited to credit quality indicators at the end of the reporting period by class of financing receivables, the aging of past due financing receivables by class, the nature and extent of financing receivables modified as troubled debt restructurings by class and the effect on the allowance for credit losses. For public entities, the disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. The adoption of this Standard did not impact the Association’s financial condition or results of operations, but did result in significant additional disclosures.

In January 2010, the FASB issued guidance on “Fair Value Measurements and Disclosures,” which is to improve disclosures about fair value measurement by increasing transparency in financial reporting. The changes will provide a greater level of disaggregated information and more robust disclosures of valuation techniques and inputs to fair value measurement. The new disclosures and clarification of existing disclosures were effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances and settlements in the rollforward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The adoption of this Standard did not impact the Association’s financial condition or results of operations but did result in additional disclosures.

#### **Relationship with the Farm Credit Bank of Texas:**

The Association’s financial condition may be impacted by factors that affect the Bank. The financial condition and results of operations of the Bank may materially affect the stockholder’s investment in the Association. The Management’s Discussion and Analysis and Notes to Financial Statements contained in the December 31, 2010 Annual Report of Legacy Ag Credit, ACA more fully describe the Association’s relationship with the Bank.

The Texas Farm Credit District’s (District) annual and quarterly stockholder reports are available free of charge, upon request. These reports can be obtained by writing to Farm Credit Bank of Texas, The Ag Agency, P.O. Box 202590, Austin, Texas 78720, or by calling (512) 483-9204. Copies of the District’s quarterly and annual stockholder reports also can be requested by e-mail at [fcb@farmcreditbank.com](mailto:fcb@farmcreditbank.com). The District makes its annual and quarterly stockholder reports available on its website at [www.farmcreditbank.com](http://www.farmcreditbank.com).

The Association’s quarterly stockholder reports are also available free of charge, upon request. These reports can be obtained by writing to Legacy Ag Credit, ACA, 303 Connally St., Sulphur Springs, Texas, 75482 or calling (903) 885-9566. Copies of the Association’s quarterly stockholder reports can also be requested by e-mailing [sherry.jennings@legacycreditaca.com](mailto:sherry.jennings@legacycreditaca.com).

**LEGACY AG CREDIT, ACA**

**CONSOLIDATED BALANCE SHEET**

	<b>September 30, 2011 (unaudited)</b>	<b>December 31, 2010</b>
<b><u>ASSETS</u></b>		
Cash	\$ 461,370	\$ 63,374
Loans	222,956,892	250,449,194
Less: allowance for loan losses	9,338,794	10,395,535
Net loans	213,618,098	240,053,659
Accrued interest receivable	1,500,553	1,601,115
Investment in and receivable from the Bank:		
Capital stock	4,745,575	4,745,575
Other	318,413	1,633,221
Other property owned, net	4,495,720	3,808,889
Premises and equipment	606,466	540,248
Other assets	262,187	380,338
Total assets	<b>\$ 226,008,382</b>	<b>\$ 252,826,419</b>
<b><u>LIABILITIES</u></b>		
Note payable to the Bank	\$ 186,195,601	\$ 212,404,963
Advance conditional payments	23,891	1,203
Accrued interest payable	479,398	594,100
Drafts outstanding	55,031	36,438
Dividends payable	4,315	4,315
Other liabilities	474,075	559,825
Total liabilities	<b>187,232,311</b>	<b>213,600,844</b>
<b><u>MEMBERS' EQUITY</u></b>		
Capital stock and participation certificates	1,028,985	1,121,985
Unallocated retained earnings	37,566,325	37,898,772
Accumulated other comprehensive income	180,761	204,818
Total members' equity	<b>38,776,071</b>	<b>39,225,575</b>
Total liabilities and members' equity	<b>\$ 226,008,382</b>	<b>\$ 252,826,419</b>

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

LEGACY AG CREDIT, ACA

CONSOLIDATED STATEMENT OF INCOME

(unaudited)

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
<b><u>INTEREST INCOME</u></b>				
Loans	\$ 3,134,534	\$ 3,211,268	\$ 9,445,826	\$ 10,838,054
<b><u>INTEREST EXPENSE</u></b>				
Note payable to the Bank	1,498,595	1,923,415	4,751,321	5,921,293
Net interest income	1,635,939	1,287,853	4,694,505	4,916,761
<b><u>PROVISION FOR LOAN LOSSES</u></b>				
	1,428,182	679,802	2,283,984	4,196,141
Net interest income after provision for loan losses	207,757	608,051	2,410,521	720,620
<b><u>NONINTEREST INCOME</u></b>				
Income from the Bank:				
Patronage income	35,497	40,804	107,797	124,881
Loan fees	38,075	63,659	90,209	185,940
Financially related services income	137	212	572	704
Gain on other property owned, net	-	40,175	-	2,894
Other noninterest income	628	-	14,910	284,298
Total noninterest income	74,337	144,850	213,488	598,717
<b><u>NONINTEREST EXPENSES</u></b>				
Salaries and employee benefits	516,174	512,640	1,530,606	1,428,850
Directors' expense	25,096	42,367	137,460	155,486
Purchased services	143,798	133,000	395,581	355,107
Travel	42,128	33,053	111,479	90,067
Occupancy and equipment	31,754	29,963	103,590	76,842
Communications	10,657	10,522	28,626	27,791
Advertising	13,013	4,074	25,468	16,976
Public and member relations	6,611	4,859	26,883	22,619
Supervisory and exam expense	34,449	38,640	111,730	104,255
Insurance Fund premiums	35,984	38,700	116,413	111,255
Provision for other property owned	-	80	90,919	258,045
Loss on other property owned, net	126,395	-	149,976	-
Other noninterest expense	28,097	15,610	127,725	92,489
Total noninterest expenses	1,014,156	863,508	2,956,456	2,739,782
Net loss	\$ (732,062)	\$ (110,607)	\$ (332,447)	\$ (1,420,445)

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

LEGACY AG CREDIT, ACA

CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY

(unaudited)

	<u>Capital Stock/ Participation Certificates</u>	<u>Retained Earnings Unallocated</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total Members' Equity</u>
Balance at December 31, 2009	\$ 1,192,640	\$ 41,804,763	\$ 124,031	\$ 43,121,434
Comprehensive income				
Net loss	-	(1,420,445)	-	(1,420,445)
Change in postretirement benefit plans	-	-	(15,185)	(15,185)
Total comprehensive income	-	(1,420,445)	(15,185)	(1,435,630)
Capital stock/participation certificates and allocated retained earnings issued	39,310	-	-	39,310
Capital stock/participation certificates and allocated retained earnings retired	(89,320)	-	-	(89,320)
Patronage refunds:				
Cash	-	-	-	-
Balance at September 30, 2010	<u>\$ 1,142,630</u>	<u>\$ 40,384,318</u>	<u>\$ 108,846</u>	<u>\$ 41,635,794</u>
Balance at December 31, 2010	\$ 1,121,985	\$ 37,898,772	\$ 204,818	\$ 39,225,575
Comprehensive income				
Net loss	-	(332,447)	-	(332,447)
Change in postretirement benefit plans	-	-	(24,057)	(24,057)
Total comprehensive income	-	(332,447)	(24,057)	(356,504)
Capital stock/participation certificates and allocated retained earnings issued	34,395	-	-	34,395
Capital stock/participation certificates and allocated retained earnings retired	(127,395)	-	-	(127,395)
Patronage refunds:				
Cash	-	-	-	-
Balance at September 30, 2011	<u>\$ 1,028,985</u>	<u>\$ 37,566,325</u>	<u>\$ 180,761</u>	<u>\$ 38,776,071</u>

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

**LEGACY AG CREDIT, ACA**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(UNAUDITED)

**NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES:**

Legacy Ag Credit, ACA (Agricultural Credit Association), referred to as the Association, is a member-owned cooperative that provides credit and credit-related services to or for the benefit of eligible borrowers/stockholders for qualified agricultural purposes. The Association serves the counties of Franklin, Gregg, Harrison, Hopkins, Kaufman, Marion, Rains, Upshur, Van Zandt, and Wood in the state of Texas. The Association is a lending institution of the Farm Credit System (the System), which was established by Acts of Congress to meet the needs of American agriculture.

The significant accounting policies followed and the financial condition and results of operations of the Association as of and for the year ended December 31, 2010 are contained in the 2010 Annual Report to Stockholders. These unaudited third quarter 2011 financial statements should be read in conjunction with the 2010 Annual Report to Stockholders.

In September 2011, the Financial Accounting Standards Board (FASB) issued guidance entitled, “Compensation – Retirement Benefits – Multiemployer Plans.” The guidance is intended to provide more information about an employer’s financial obligations to a multiemployer pension plan, which should help financial statement users better understand the financial health of significant plans that the employer participates. The additional disclosures include: a) a description of the nature of plan benefits, b) a qualitative description of the extent to which the employer could be responsible for the obligations of the plan, including benefits earned by employees during employment with another employer, and c) other quantitative information to help users understand the financial information about the plan. The amendments are effective for annual periods for fiscal years ending after December 15, 2011 for public entities or for annual periods for fiscal years ending after December 15, 2012 for non-public entities. The amendments should be applied retrospectively for all prior periods presented.

In June 2011, the Financial Accounting Standards Board (FASB) issued guidance entitled, “Comprehensive Income – Presentation of Comprehensive Income.” This guidance is intended to increase the prominence of other comprehensive income in financial statements. The current option that permits the presentation of other comprehensive income in the statement of changes in equity has been eliminated. The main provisions of the guidance provides that an entity that reports items of other comprehensive income has the option to present comprehensive income in either one or two consecutive financial statements:

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- In a two-statement approach, an entity must present the components of net income and total net income in the first statement. That statement must be immediately followed by a financial statement that presents the components of other comprehensive income, a total for other comprehensive income, and a total for comprehensive income.

This guidance is to be applied retrospectively and is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The adoption of this guidance will not impact financial condition or results of operations, but will result in changes to the presentation of comprehensive income.

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3. Clarifying that a reporting entity should disclose quantitative information about the unobservable inputs used in a fair value measurement that is categorized within Level 3 of the fair value hierarchy.
4. An exception to the requirement for measuring fair value when a reporting entity manages its financial instruments on the basis of its net exposure, rather than its gross exposure, to those risks.
5. Clarifying that the application of premiums and discounts in a fair value measurement is related to the unit of account for the asset or liability being measured at fair value. Premiums or discounts related to size as a characteristic of the entity’s

holding (that is, a blockage factor) instead of as a characteristic of the asset or liability (for example, a control premium), are not permitted. A fair value measurement that is not a Level 1 measurement may include premiums or discounts other than blockage factors when market participants would incorporate the premium or discount into the measurement at the level of the unit of account specified in other guidance.

6. Expansion of the disclosures about fair value measurements. The most significant change will require entities, for their recurring Level 3 fair value measurements, to disclose quantitative information about unobservable inputs used, a description of the valuation processes used by the entity, and a qualitative discussion about the sensitivity of the measurements. New disclosures are required about the use of a nonfinancial asset measured or disclosed at fair value if its use differs from its highest and best use. In addition, entities must report the level in the fair value hierarchy of assets and liabilities not recorded at fair value but where fair value is disclosed.

The amendments are to be applied prospectively. The amendments are effective during interim and annual periods beginning after December 15, 2011. Early application is not permitted.

In January 2011, the FASB issued guidance entitled, “Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings.” This guidance temporarily delayed the effective date of the disclosures about troubled debt restructurings required by the guidance previously issued on “Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses.” The effective date of the new disclosures about troubled debt restructurings (TDR) coincides with the guidance for determining what constitutes a TDR as described below.

In April 2011, the FASB issued its guidance entitled, “A Creditor’s Determination of Whether a Restructuring is a Troubled Debt Restructuring,” which provides for clarification on whether a restructuring constitutes a TDR. In evaluating whether a restructuring is a TDR, a creditor must separately conclude that both of the following exists: (1) the restructuring constitutes a concession, and (2) the debtor is experiencing financial difficulties. For nonpublic entities, the guidance is effective for annual periods ending on or after December 15, 2012, including interim periods within those annual periods. The Association is currently evaluating the impact of adoption of this Standard on the financial condition or results of operations. The adoption will result in additional disclosures.

In July 2010, the FASB issued guidance on “Disclosures about the Credit Quality of Financing Receivables and the Allowance for Loan Losses,” which is intended to provide additional information to assist financial statement users in assessing an entity’s credit risk exposures and evaluating the adequacy of the allowance for credit losses. Existing disclosures are amended to include additional disclosures of financing receivables on a disaggregated basis (by portfolio segment and class of financing receivable) including among others, a rollforward schedule of the allowance for credit losses from the beginning of the reporting period to the end of the period on a portfolio segment basis, with the ending balance further disaggregated on the basis of the method of impairment (individually or collectively evaluated). The guidance also calls for new disclosures including but not limited to credit quality indicators at the end of the reporting period by class of financing receivables, the aging of past due financing receivables by class, the nature and extent of financing receivables modified as troubled debt restructurings by class and the effect on the allowance for credit losses. For public entities, the disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. The adoption of this Standard did not impact the Association’s financial condition or results of operations, but did result in additional disclosures.

In January 2010, the FASB issued guidance on “Fair Value Measurements and Disclosures,” which is to improve disclosures about fair value measurement by increasing transparency in financial reporting. The changes will provide a greater level of disaggregated information and more robust disclosures of valuation techniques and inputs to fair value measurement. The new disclosures and clarification of existing disclosures were effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances and settlements in the rollforward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The adoption of this Standard did not impact the Association’s financial condition and results of operations but did result in additional disclosures.

The accompanying consolidated financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations and conform with generally accepted accounting principles, except for the inclusion of a statement of cash flows. Generally accepted accounting principles require a business enterprise that provides a set of financial statements reporting both financial position and results of operations to also provide a statement of cash flows for each period for which results of operations are provided. In regulations issued by FCA, associations have the option to exclude statements of cash flows in interim financial statements. Therefore, the Association has elected not to include a statement of cash flows in these consolidated financial statements.

The consolidated financial statements comprise the operations of the ACA and its wholly-owned subsidiaries. The preparation of these consolidated financial statements requires the use of management’s estimates. The results for the quarter ended September 30,

2011, are not necessarily indicative of the results to be expected for the year ended December 31, 2011. Certain amounts in the prior period's financial statements have been reclassified to conform to current financial statement presentation.

**NOTE 2 — LOANS AND ALLOWANCE FOR LOAN LOSSES:**

A summary of loans follows:

Loan Type	September 30, 2011 Amount	December 31, 2010 Amount
Production agriculture:		
Real estate mortgage	\$ 197,849,219	\$ 220,759,467
Production and intermediate term	12,332,099	20,987,514
Agribusiness:		
Loans to cooperatives	74,930	1,164,164
Processing and marketing	5,633,318	1,952,073
Farm-related business	-	1,855,010
Communication	825,301	1,711,699
Energy	2,565,106	65,802
Water and waste disposal	1,924,051	-
Rural residential real estate	1,752,868	1,953,465
International	-	-
Lease receivables	-	-
Total	\$ 222,956,892	\$ 250,449,194

The Association purchases or sells participation interests with other parties in order to diversify risk, manage loan volume and comply with Farm Credit Administration regulations. The following table presents information regarding the balances of participations purchased and sold at September 30, 2011:

	Other Farm Credit Institutions		Non-Farm Credit Institutions		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
	Real estate mortgage	\$ 2,122,669	\$ -	\$ -	\$ -	\$ 2,122,669
Production and intermediate term	496,515	-	-	-	496,515	-
Agribusiness	5,708,249	-	-	-	5,708,249	-
Communication	825,301	-	-	-	825,301	-
Energy	2,500,000	-	-	-	2,500,000	-
Water and waste disposal	1,924,051	-	-	-	1,924,051	-
Rural residential real estate	-	-	-	-	-	-
International	-	-	-	-	-	-
Lease receivables	-	-	-	-	-	-
Total	\$ 13,576,785	\$ -	\$ -	\$ -	\$ 13,576,785	\$ -

Impaired assets (including related accrued interest) and related credit quality statistics are as follows:

	<b>September 30, 2011</b>	December 31, 2010
<b>Nonaccrual loans:</b>		
Real estate mortgage	<b>\$ 26,722,042</b>	\$ 35,867,675
Production and intermediate term	<b>4,283,423</b>	7,906,410
Agribusiness	-	1,855,010
Communication	-	-
Rural residential real estate	<b>28,866</b>	30,515
Energy and water/waste disposal	-	-
Lease receivables	-	-
Total nonaccrual loans	<b>\$ 31,034,331</b>	\$ 45,659,610
<b>Accruing restructured loans:</b>		
Real estate mortgage	<b>1,309,405</b>	-
Production and intermediate term	-	-
Agribusiness	-	-
Total accruing restructured loans	<b>\$ 1,309,405</b>	\$ -
<b>Accruing loans 90 days or more past due:</b>		
Real estate mortgage	<b>208,241</b>	-
Production and intermediate term	-	-
Agribusiness	-	-
Rural residential real estate	-	-
Communication	-	-
Lease receivables	-	-
Total accruing loans 90 days or more	<b>\$ 208,241</b>	\$ -
Total nonperforming loans	<b>\$ 32,551,977</b>	\$ 45,659,610
Other property owned	<b>\$ 4,495,720</b>	\$ 3,808,889
Total nonperforming assets	<b>\$ 37,047,697</b>	\$ 49,468,499

One credit quality indicator utilized by the Association is the Farm Credit Administration Uniform Loan Classification System that categorizes loans into five categories. The categories are defined as follows:

- Acceptable – assets are expected to be fully collectible and represent the highest quality,
- Other assets especially mentioned (OAEM) – assets are currently collectible but exhibit some potential weakness,
- Substandard – assets exhibit some serious weakness in repayment capacity, equity and/or collateral pledged on the loan,
- Doubtful – assets exhibit similar weaknesses to substandard assets; however, doubtful assets have additional weaknesses in existing factors, conditions and values that make collection in full highly questionable, and
- Loss – assets are considered uncollectible.

The following table shows loans and related accrued interest as a percentage of total loans and related accrued interest receivable by loan type as of:

	<b>September 30, 2011</b>	December 31, 2010
Real estate mortgage		
Acceptable	<b>60.5</b> %	63.1 %
OAEM	<b>21.5</b>	17.7
Substandard/doubtful	<b>18.0</b>	19.2
	<b>100.0</b>	100.0
Production and intermediate term		
Acceptable	<b>26.1</b>	26.8
OAEM	<b>3.7</b>	12.5
Substandard/doubtful	<b>70.2</b>	60.7
	<b>100.0</b>	100.0
Agribusiness		
Acceptable	<b>79.8</b>	100.0
OAEM	-	-
Substandard/doubtful	<b>20.2</b>	-
	<b>100.0</b>	100.0
Energy and water/waste disposal		
Acceptable	<b>100.0</b>	100.0
OAEM	-	-
Substandard/doubtful	-	-
	<b>100.0</b>	100.0
Communication		
Acceptable	<b>100.0</b>	100.0
OAEM	-	-
Substandard/doubtful	-	-
	<b>100.0</b>	100.0
Rural residential real estate		
Acceptable	<b>81.3</b>	81.3
OAEM	<b>17.1</b>	17.1
Substandard/doubtful	<b>1.6</b>	1.6
	<b>100.0</b>	100.0
International		
Acceptable	-	-
OAEM	-	-
Substandard/doubtful	-	-
	-	-
Lease receivables		
Acceptable	-	-
OAEM	-	-
Substandard/doubtful	-	-
	-	-
Total Loans		
Acceptable	<b>63.5</b>	60.0
OAEM	<b>17.1</b>	16.7
Substandard/doubtful	<b>19.4</b>	23.3
	<b>100.0</b> %	100.0 %

The following table provides an age analysis of past due loans (including accrued interest) as of September 30, 2011:

	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due or Less Than 30 Days Past Due	Total Loans	Recorded Investment >90 Days and Accruing
Real estate mortgage	\$ 1,753,120	\$ 2,861,246	\$ 4,614,366	\$ 194,636,342	\$ 199,250,708	\$ 202,891
Production and intermediate term	533,357	559,307	1,092,664	11,309,841	12,402,505	-
Loans to cooperatives	-	-	-	75,086	75,086	-
Processing and marketing	-	-	-	5,639,329	5,639,329	-
Farm-related business	-	-	-	-	-	-
Communication	-	-	-	825,378	825,378	-
Energy and water/waste disposal	-	-	-	4,504,828	4,504,828	-
Rural residential real estate	-	-	-	1,759,611	1,759,611	-
International	-	-	-	-	-	-
Lease receivables	-	-	-	-	-	-
Total	\$ 2,286,477	\$ 3,420,553	\$ 5,707,030	\$ 218,750,415	\$ 224,457,445	\$ 202,891

Note: The recorded investment in the receivable is the face amount increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges, or acquisition costs and may also reflect a previous direct write-down of the investment.

Additional impaired loan information is as follows:

	At September 30, 2011			For the Three Months Ended September 30, 2011		For the Nine Months Ended September 30, 2011	
	Recorded	Unpaid	Related	Average	Interest	Average	Interest
	Investment	Principal Balance <sup>a</sup>	Allowance	Impaired Loans	Income Recognized	Impaired Loans	Income Recognized
Impaired loans with a related allowance for credit losses:							
Real estate mortgage	\$ 17,432,015	\$ 17,446,198	\$ 5,853,480	\$ 15,701,488	\$ 75,157	\$ 15,725,180	\$ 78,400
Production and intermediate term	2,194,128	3,532,833	1,001,507	2,273,745	1,767	4,515,170	2,481
Loans to cooperatives	-	-	-	-	-	-	-
Processing and marketing	-	-	-	-	-	-	-
Farm-related business	-	-	-	-	-	-	-
Communication	-	-	-	-	-	-	-
Energy and water/waste disposal	-	-	-	-	-	-	-
Rural residential real estate	-	-	-	14,748	-	-	-
International	-	-	-	-	-	-	-
Lease receivables	-	-	-	-	-	-	-
Total	\$ 19,626,143	\$ 20,979,031	\$ 6,854,987	\$ 17,989,981	\$ 76,924	\$ 20,240,350	\$ 80,881
Impaired loans with no related allowance for credit losses:							
Real estate mortgage	\$ 9,498,269	\$ 9,625,213	\$ -	\$ 12,840,399	\$ 42,693	\$ 16,643,971	\$ 209,277
Production and intermediate term	2,089,294	5,620,394	-	2,411,006	-	1,579,747	4,955
Loans to cooperatives	-	-	-	-	-	-	-
Processing and marketing	-	-	-	-	-	-	-
Farm-related business	-	-	-	927,505	-	-	-
Communication	-	-	-	-	-	-	-
Energy and water/waste disposal	-	-	-	-	-	-	-
Rural residential real estate	28,866	28,876	-	14,433	-	29,690	-
International	-	-	-	-	-	-	-
Lease receivables	-	-	-	-	-	-	-
Total	\$ 11,616,429	\$ 15,274,483	\$ -	\$ 16,193,343	\$ 42,693	\$ 18,253,408	\$ 214,232
Total impaired loans:							
Real estate mortgage	\$ 26,930,284	\$ 27,071,411	\$ 5,853,480	\$ 28,541,887	\$ 117,850	\$ 32,369,151	\$ 287,677
Production and intermediate term	4,283,422	9,153,227	1,001,507	4,684,751	1,767	6,094,917	7,436
Loans to cooperatives	-	-	-	-	-	-	-
Processing and marketing	-	-	-	-	-	-	-
Farm-related business	-	-	-	927,505	-	-	-
Communication	-	-	-	-	-	-	-
Energy and water/waste disposal	-	-	-	-	-	-	-
Rural residential real estate	28,866	28,876	-	29,181	-	29,690	-
International	-	-	-	-	-	-	-
Lease receivables	-	-	-	-	-	-	-
Total	\$ 31,242,572	\$ 36,253,514	\$ 6,854,987	\$ 34,183,324	\$ 119,617	\$ 38,493,758	\$ 295,113

	At December 31, 2010			For the Year Ended December 31, 2010	
	Recorded Investment	Unpaid Principal Balance <sup>a</sup>	Related Allowance	Average Impaired Loans	Interest Income Recognized
Impaired loans with a related allowance for credit losses:					
Real estate mortgage	\$ 14,018,346	\$ 14,018,346	\$ 4,185,169	\$ 10,465,522	\$ 186,969
Production and intermediate term	6,836,211	6,850,675	3,967,670	6,573,965	72,891
Loans to cooperatives	-	-	-	-	-
Processing and marketing	-	-	-	-	-
Farm-related business	-	-	-	-	-
Communication	-	-	-	-	-
Energy and water/waste disposal	-	-	-	-	-
Rural residential real estate	-	-	-	-	-
International	-	-	-	-	-
Lease receivables	-	-	-	-	-
<b>Total</b>	<b>\$ 20,854,557</b>	<b>\$ 20,869,021</b>	<b>\$ 8,152,839</b>	<b>\$ 17,039,487</b>	<b>\$ 259,860</b>
Impaired loans with no related allowance for credit losses:					
Real estate mortgage	\$ 23,794,993	\$ 23,861,355	\$ -	\$ 15,188,832	\$ 238,351
Production and intermediate term	1,070,199	1,070,199	-	3,956,401	25,430
Loans to cooperatives	-	-	-	-	-
Processing and marketing	-	-	-	-	-
Farm-related business	-	-	-	-	-
Communication	-	-	-	-	-
Energy and water/waste disposal	-	-	-	-	-
Rural residential real estate	30,515	30,525	-	-	552
International	-	-	-	-	-
Lease receivables	-	-	-	-	-
<b>Total</b>	<b>\$ 24,895,707</b>	<b>\$ 24,962,079</b>	<b>\$ -</b>	<b>\$ 19,145,233</b>	<b>\$ 264,333</b>
Total impaired loans:					
Real estate mortgage	\$ 37,813,339	\$ 37,879,701	\$ 4,185,169	\$ 25,654,354	\$ 425,320
Production and intermediate term	7,906,410	7,920,874	3,967,670	10,530,366	98,321
Loans to cooperatives	-	-	-	-	-
Processing and marketing	-	-	-	-	-
Farm-related business	-	-	-	-	-
Communication	-	-	-	-	-
Energy and water/waste disposal	-	-	-	-	-
Rural residential real estate	30,515	30,525	-	30,525	552
International	-	-	-	-	-
Lease receivables	-	-	-	-	-
<b>Total</b>	<b>\$ 45,750,264</b>	<b>\$ 45,831,100</b>	<b>\$ 8,152,839</b>	<b>\$ 36,215,245</b>	<b>\$ 524,193</b>

<sup>a</sup> Unpaid principal balance represents the recorded principal balance of the loan.

A summary of changes in the allowance for loan losses and period end recorded investment in loans is as follows:

	Real Estate Mortgage	Production and Intermediate Term	Agribusiness	Communications	Energy and Water/Waste Disposal	Rural Residential Real Estate	Inter National	Lease Receivable	Total
<b>Allowance for Credit Losses:</b>									
Balance at									
December 31, 2010	\$ 5,843,908	\$ 4,471,835	\$ 75,658	\$ -	\$ -	\$ 4,134	\$ -	\$ -	\$ 10,395,535
Charge-offs	(1,504,108)	(1,965,278)	-	-	-	(954)	-	-	(3,470,340)
Recoveries	23,250	105,411	-	-	-	954	-	-	129,615
Provision for loan losses	3,450,018	(1,142,177)	(39,827)	974	15,504	(508)	-	-	2,283,984
Adjustment due to merger	-	-	-	-	-	-	-	-	-
Other	-	-	-	-	-	-	-	-	-
Balance at									
September 30, 2011	\$ 7,813,068	\$ 1,469,791	\$ 35,831	\$ 974	\$ 15,504	\$ 3,626	\$ -	\$ -	\$ 9,338,794
Ending Balance:									
individually evaluated for impairment	\$ 5,853,483	\$ 1,001,507	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 6,854,990
Ending Balance:									
collectively evaluated for impairment	\$ 1,959,585	\$ 468,284	\$ 35,831	\$ 974	\$ 15,504	\$ 3,626	\$ -	\$ -	\$ 2,483,804
Ending Balance: loans acquired with deteriorated credit quality	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
<b>Recorded Investments in Loans Outstanding:</b>									
Ending Balance at									
September 30, 2011	\$ 199,250,708	\$ 12,402,505	\$ 5,714,415	\$ 825,378	\$ 4,504,828	\$ 1,759,611	\$ -	\$ -	\$ 224,457,445
Ending Balance for loans individually evaluated for impairment	\$ 17,432,015	\$ 2,194,128	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 19,626,143
Ending Balance for loans collectively evaluated for impairment	\$ 181,818,693	\$ 10,208,377	\$ 5,714,415	\$ 825,378	\$ 4,504,828	\$ 1,759,611	\$ -	\$ -	\$ 204,831,302
Ending Balance for loans acquired with deteriorated credit quality	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -

### NOTE 3 — CAPITAL:

The Association's board of directors has established a Capital Adequacy Plan (Plan) that includes the capital targets that are necessary to achieve the institution's capital adequacy goals as well as the minimum permanent capital standards. The Plan monitors projected dividends, equity retirements and other actions that may decrease the Association's permanent capital. In addition to factors that must be considered in meeting the minimum standards, the board of directors also monitors the following factors: capability of management; quality of operating policies, procedures, and internal controls; quality and quantity of earnings; asset quality and the adequacy of the allowance for losses to absorb potential loss within the loan and lease portfolios; sufficiency of liquid funds; needs of an institution's customer base; and any other risk-oriented activities, such as funding and interest rate risk, potential obligations under joint and several liability, contingent and off-balance-sheet liabilities or other conditions warranting additional capital. At least quarterly, management reviews the Association's goals and objectives with the board.

#### NOTE 4 — INCOME TAXES:

Legacy Ag Credit, ACA and its subsidiary are subject to federal and certain other income taxes. The Associations are eligible to operate as cooperatives that qualify for tax treatment under Subchapter T of the Internal Revenue code. Under specified conditions, the associations can exclude from taxable income amounts distributed as qualified patronage refunds in the form of cash, stock or allocated surplus. Provisions for income taxes are made only on those earnings that will not be distributed as qualified patronage refunds. During the nine months ended September 30, 2011, the Association did not participate in a patronage program. Deferred taxes are recorded at the tax effect of all temporary differences based on the assumption that such temporary differences are retained by the institution and will therefore impact future tax payments. A valuation allowance is provided against deferred tax assets to the extent that it is more likely than not (more than 50 percent probability), based on management's estimate, that they will not be realized. For the nine months ended September 30, 2011, net loss for tax purposes from the Association's PCA subsidiary was \$661,828, and the Association's deferred tax assets were \$0, which includes a 100% valuation allowance.

The subsidiary, Legacy Land Bank, FLCA, is exempt from federal and other income taxes as provided in the Farm Credit Act of 1971.

#### NOTE 5 — FAIR VALUE MEASUREMENTS:

FASB guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability. See Note 10 to the 2010 Annual Report to Stockholders for a more complete description.

Assets and liabilities measured at fair value on a non-recurring basis for each of the fair value hierarchy values are summarized below:

<u>September 30, 2011</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Assets:				
Loans *	\$ -	\$ -	\$22,553,994	\$22,553,994
Other property owned	-	-	4,163,000	4,163,000
<u>December 31, 2010</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Assets:				
Loans *	\$ -	\$ -	\$ 27,599,144	\$ 27,599,144
Other property owned	-	-	1,085,000	1,085,000

\*Represents the fair value of certain loans that were evaluated for impairment under authoritative guidance, "Accounting by Creditors for Impairment of a Loan." The fair value was based upon the underlying collateral since these were collateral-dependent loans for which real estate is the collateral.

#### Valuation Techniques

As more fully discussed in Note 2 to the 2010 Annual Report to Stockholders, authoritative guidance establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The following represent a brief summary of the valuation techniques used for the Associations' assets and liabilities. For a more complete description, see Notes to the 2010 Annual Report to Stockholders

#### Loans

For certain loans evaluated for impairment under authoritative guidance, the fair value is based upon the underlying collateral since the loans were collateral-dependent loans for which real estate is the collateral. The fair value measurement process uses independent appraisals and other market-based information, but in many cases it also requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the collateral and other matters. As a result, these fair value measurements fall within Level 3 of the hierarchy. When the value of the real estate, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established.

### *Other Property Owned*

Other property owned is generally classified as Level 3. The fair value is based upon the collateral value, which is generally determined using appraisals or other indications based on comparable sales of similar properties. Costs to sell represent transaction costs and are not included as a component of the asset's fair value.

### **NOTE 6 — EMPLOYEE BENEFIT PLANS:**

The following table summarizes the components of net periodic benefit costs of non-pension other postretirement employee benefits for the months ended September 30,:

	Other Benefits	
	2011	2010
Service cost	\$ 6,955	\$ 9,625
Interest cost	9,311	13,092
Expected return on plan assets	-	-
Amortization of prior service costs	(14,846)	(15,185)
Amortizations of net (gain) loss	(9,211)	-
Net periodic benefit cost	<u>\$ (7,791)</u>	<u>\$ 7,532</u>

The Association also expects to contribute \$96,228 to its defined benefit pension plan in 2011. As of September 30, 2011, \$72,171 of contributions have been made. The Association presently anticipates contributing an additional \$24,057 to fund its defined benefit pension plan in 2011.

### **NOTE 7 — COMMITMENTS AND CONTINGENT LIABILITIES:**

The Association is involved in various legal proceedings in the normal course of business. In the opinion of legal counsel and management, there are no legal proceedings at this time that are likely to materially affect the Association

### **NOTE 8 – REGULATORY ENFORCEMENT MATTERS:**

The Association underwent an examination by the Farm Credit Administration (FCA) in early 2009. As a result of this examination, an enforcement action (Supervisory Agreement) by the FCA was instituted against the Association in November 2009. The basis of the enforcement action was unsafe and unsound practices and conditions and violations of FCA regulations within the institution.

The existing Chief Executive Officer (CEO) and Chief Credit Officer (CCO) were terminated by the Association Board in October 2009. An interim CEO was named in October of 2009 who served until the selection of a new CEO in September 2010. An interim CCO was named in September of 2010 who served until the selection of a new CCO in February 2011.

In June 2010, an examination letter issued by the FCA found significant weaknesses in the Institution's condition and performance, including several instances of noncompliance with the November 2009 Supervisory Agreement.

A September 2010 Report of Examination (ROE), found that the Board adequately responded to the June 2010 letter by demonstrating an increased commitment to supervisory requirements.

The September 2010 ROE stated that the Board's compliance with the Agreement had improved, and that all previous noncompliance ratings were raised to partial or substantial compliance.

The September 2010 ROE also found that despite the improved compliance and actions taken, only limited progress had been made towards restoring the Association to a safe and sound institution.

In March of 2011, a revised Supervisory Agreement was entered into between the FCA and the Association's Board which supersedes and terminates the November 2009 Supervisory Agreement.

In general, the basis for the revised Supervisory Agreement is that the Board's actions and corrective action plans, although improving, have not yet resulted in a substantial improvement in the quality of the Institution's portfolio or the Institution's financial condition and performance.

Requirements placed on the Institution and Board related to the revised agreement include: the Board continuing to fulfill its fiduciary duties to the institution and its stockholders; continuing the engagement of the Board Consultant; continuation of the Compliance Committee's monitoring and coordination of the Institution's adherence to the provisions of the agreement; and continuing to review, revise and adopt appropriate Association Policies including Borrowers Rights, Standard of Conduct, and Information Technology.

The Board is also required to review, update, and approve corrective action plans on the following: Audit Committee; Internal Controls; Loan Portfolio Management; Capital, Earnings, and Liquidity.

The revised agreement also requires the Board to: complete a staffing plan; improve its methodology concerning the allowance for loan loss; and provide monthly reporting on large criticized assets.

The Board is also required to disclose a summary of items regarding the revised agreement.

The Board has directed management to take actions required to bring the Association into compliance with the articles of the revised agreement. The Board has begun addressing, updating, and approving policies as required. The Board and management have implemented the process of reviewing, updating, and approving the original plans as directed by the revised agreement. The Board will continue to work with the Board Consultant to insure proper corrective actions are taken in response to this agreement. The Board will also continue to attend additional training in order to improve its supervisory effectiveness.

The actions taken by the Board and management in order to comply with the revised agreement include: updating and approving policies concerning standards of conduct, borrowers rights, and information technology, as well as reviewing, updating, and approving corrective action plans on internal controls, audit committee, portfolio management, capital, earnings, and liquidity. The Board will continue to monitor the status and progress of management's corrective actions in compliance with the revised plan. The Board will continue to update the FCA and its stockholders as to its compliance with the revised agreement on a quarterly basis.

The Board and management are dedicated to meeting their obligation in complying with the revised agreement, and believe the actions taken to date and those that will be taken in the future will result in a safe and sound Association which will better meet the financing needs of its stockholders.

**NOTE 9 — SUBSEQUENT EVENTS:**

The Association has evaluated subsequent events through November 3, 2011, which is the date the financial statements were issued. There are no subsequent events to report.