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*AgSouth Farm Credit, ACA*

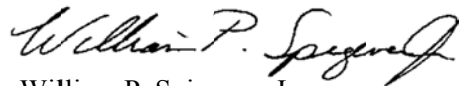
# FIRST QUARTER 2014

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## CERTIFICATION

The undersigned certify that we have reviewed the March 31, 2014 quarterly report of AgSouth Farm Credit, ACA, that the report has been prepared under the oversight of the Audit Committee of the Board of Directors and in accordance with all applicable statutory or regulatory requirements, and that the information contained herein is true, accurate, and complete to the best of our knowledge and belief.



William P. Spigener, Jr.  
Chief Executive Officer



Alisa D. Gunter  
Chief Financial Officer



Charles C. Rucks  
Chairman of the Board

May 9, 2014

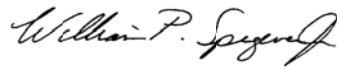
# Report on Internal Control Over Financial Reporting

The Association's principal executives and principal financial officers, or persons performing similar functions, are responsible for establishing and maintaining adequate internal control over financial reporting for the Association's Consolidated Financial Statements. For purposes of this report, "internal control over financial reporting" is defined as a process designed by, or under the supervision of the Association's principal executives and principal financial officers, or persons performing similar functions, and affected by its Board of Directors, management and other personnel. This process provides reasonable assurance regarding the reliability of financial reporting information and the preparation of the Consolidated Financial Statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

Internal control over financial reporting includes those policies and procedures that: (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Association, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial information in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures are being made only in accordance with authorizations of management and directors of the Association, and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Association's assets that could have a material effect on its Consolidated Financial Statements.

The Association's management has completed an assessment of the effectiveness of internal control over financial reporting as of March 31, 2014. In making the assessment, management used the framework in *Internal Control — Integrated Framework*, promulgated by the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as the "COSO" criteria.

Based on the assessment performed, the Association concluded that as of March 31, 2014, the internal control over financial reporting was effective based upon the COSO (1992) criteria. Additionally, based on this assessment, the Association determined that there were no material weaknesses in the internal control over financial reporting as of March 31, 2014.



William P. Spigener  
Chief Executive Officer



Alisa D. Gunter  
Chief Financial Officer

May 9, 2014

# Management's Discussion and Analysis of Financial Condition and Results of Operations

*(dollars in thousands)*

The following commentary reviews the financial condition and results of operations of AgSouth Farm Credit, ACA (Association) for the period ended March 31, 2014. This information should be read in conjunction with the accompanying financial statements, notes to the financial statements, and the 2013 Annual Report of AgSouth Farm Credit. The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors.

## FORWARD LOOKING INFORMATION

This quarterly report contains forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. Words such as "anticipates," "believes," "could," "estimates," "may," "should," "will," or other variations of these terms are intended to identify the forward-looking statements. These statements are based on assumptions and analyses made in light of experience and other historical trends, current conditions, and expected future developments. However, actual results and developments may differ materially from our expectations and predictions due to a number of risks and uncertainties, many of which are beyond our control. These risks and uncertainties include, but are not limited to:

- political, legal, regulatory and economic conditions and developments in the United States and abroad;
- economic fluctuations in the agricultural, rural utility, international, and farm-related business sectors;
- weather-related, disease, and other adverse climatic or biological conditions that periodically occur that impact agricultural productivity and income;
- changes in United States government support of the agricultural industry; and
- actions taken by the Federal Reserve System in implementing monetary policy.

## LOAN PORTFOLIO

The Association provides funds to farmers, rural homeowners and farm-related businesses for financing of short and intermediate-term loans and long-term real estate mortgage

loans. The Association's loan portfolio is diversified over a wide range of agricultural commodities produced in our region, including poultry (broilers, turkeys and eggs), timber, sod and nursery, field grains, soybeans and hay, cotton, horses, blueberries, fruits, nuts and beef cattle. Loans to producers of these commodities total \$1,274,887 or 86.68 percent of the Association's portfolio. Farm size varies, and many of the Association customers have diversified farming operations. These factors, along with the numerous opportunities for non-farm income in the area, reduce to some degree the level of income dependency on any given commodity.

During the first quarter of 2014 the Association originated \$15,357 in loans for the secondary market. Originations at the same period 2013 were \$36,514. The 57.94 percent decrease is the result of a reduction in the number of refinance requests due to increase in interest rates in the fourth quarter 2013 and the weak purchase market during first quarter 2014. AgSouth's performance mirrors the overall housing finance industry for the period. As of March 31, 2014, the Association held \$780 in qualifying loans for sale.

## Georgia Region

The Georgia region of AgSouth experienced cooler than normal temperatures with several winter storm events during the first quarter. An ice storm through much of the middle part of Georgia damaged some pine plantations, especially those which had been thinned within the past two years. Damage consisted mostly of broken tops and downed trees. Harvest operations should be able to salvage a fair percentage of the damaged trees at discounted prices.

Rainfall has been slightly above average in most areas of the state and ground water supply is good going into planting season. Soil moisture is rated short in only 2 percent of the state.

USDA estimates 76 percent of corn in Georgia is planted as of mid April and that the stand is 91 percent good to excellent. Overall corn plantings in Georgia are expected to be down to 370,000 acres or 73 percent of the 2013 planted acres. Lower early corn prices shifted more corn acres into peanuts and soybeans. Cotton acres are also estimated to be down by about 20,000 to 1,350,000 in 2014. Georgia peanuts are expected to see a significant increase estimated at 660,000 acres or 153 percent of the acreage planted in 2013. Soybeans are estimated to come in at 240,000 acres up slightly over the 230,000 planted in 2012. Tobacco continues to rise slightly each year

moving from 10,000 acres in 2012, to 12,800 in 2013, to 13,300 expected in 2014.

The Vidalia Sweet onion crop is reaching maturity and harvest will begin in late April. The crop overall looks fairly good with average to above average yields expected. USDA rates the crop as of the first week in April as 90 percent good to excellent. Some areas did incur some damage from cold temperatures coupled with wind damage, but those are estimated to be in a range of 10 to 20 percent stand reduction and fairly isolated. The price outlook for the opening of the market is expected to be good with opening prices above \$20.00 per 40lb. equivalent. If there is an above average yield prices may fall off after the first month or so following harvest.

The blueberry crop is in full bloom at this time with berries maturing soon and the crop is rated 91 percent good to excellent. Prices may start off strong and drop based on high yields. Demand for blueberries remains very good as their health benefits have been widely marketed through a number of products.

The housing market, which had shown some signs of recovery, slipped since the first of this year. The Federal Reserve Bank of Atlanta released a report that indicated the severe weather conditions during the first quarter hurt market conditions, slowed construction, reduced buyer traffic and slowed the delivery of new homes to the market. Housing prices have improved from the lows of 2009 and inventory of existing homes has been reduced. The outlook is for improvement in this market in the second and third quarters of 2014.

The forest products industry has been on a slow but steady incline since mid-2013 with improving lumber prices. Additional demand created by energy related uses for wood products in the southeast has increased demand and prices for these products. Export markets also remain good at this time.

The poultry industry in Georgia is strong at this time and many integrators are increasing production in 2014. Several integrators are adding new houses and additional growers. This is occurring in both the southeastern and northwestern portions of AgSouth territory. We expect some opportunities for new loans related to the poultry expansion.

Milk prices have been very favorable during the quarter ranging from \$23cwt to as high as \$28cwt. The outlook for milk is positive looking forward.

Unemployment has remained at around 7.4 percent for most of the first quarter down from 8.7 percent a year ago. The state's PMI index has also improved during the first quarter and is an indication that the manufacturing sector of the state's economy is improving and is an expansionary phase. Both the ports of Savannah and Brunswick set new monthly records in March 2014 with 2.61 million tons of cargo passing through Savannah and over 64,000 cars passing through Brunswick. There appears to be some momentum building in the state's economy

across many different sectors but how sustainable it is will remain to be seen. Loan demand has been very good during the first quarter with record number and amount of loan closings within the Georgia region.

### **South Carolina Region**

During the first quarter of 2014, most crop loans were repaid as expected and new farm financing has been underwritten. Many of the new loans have closed but funds advanced in the first quarter were at a slower pace than normal as spring planting was delayed slightly by colder temperatures. As a result of the heavy rains during the summer of 2013, a few farmers were required to refinance portions of unpaid loans from 2013 but most of the refinances have been closed and no major loan quality issues have been noted thus far in 2014.

Crop projections for the state in 2014 include corn acreage that will approximate 320,000 acres which will be down compared to 2013 by 30,000 acres. South Carolina cotton acreage is projected at 250,000 acres or about 8,000 acres less than the previous cycle. The state's peanut acreage is anticipated to increase by over 14,000 acres to approximately 95,000 acres in 2014 as contract prices being negotiated are favorable for reasonable profits in the coming growing cycle. Likewise, for the same reason, the soybean acreage is expected to increase by almost 40,000 acres to 360,000 acres in 2014. A significant portion of the soybean crop follows a large winter wheat crop planted in late 2013.

Topsoil moisture ratings were 77 percent adequate to surplus for the state while subsoil ratings were 84 percent adequate to surplus. The winter wheat crop, which will be harvested during the second quarter, is presently rated 78 percent good to excellent and 94 percent fair or better. Small grains including wheat, oats, and rye are all progressing well. Planted corn is at 10 percent while in 2013 corn planted for the same time period was at 37 percent. Commodity prices continue to be monitored closely and inventoried or stored crops are being moved to processors or end users at a significant pace as seasonal basis has increased prices in the region substantially.

Poultry integrators continue to do well within the state. The poultry concentration includes broilers, which is the highest percentage, combined with commercial egg and turkey operations. Expansion continues to be observed especially in broilers and this creates opportunity for the association for financing. Recent trends from integrators have led to larger farms being considered for a select group of growers. The guarantee treatment between FSA and SBA has led to the possibility of utilizing these guarantees in combination to minimize the risk associated with larger poultry farm operations.

Timber processors continue to remain very profitable and this has led to some improvement in stumpage prices paid to timberland owners within South Carolina. An ice storm that hit a portion of the AgSouth territory was estimated to have

damaged trees in 13 South Carolina counties serviced by the Association with a projected cost of approximately \$198 million. Despite this damage to both pine and hardwood timber, no repayment problems have been observed or discussed with timberland owners. The overall state of the forestry portfolio is good and showing prospects for further improvement especially if new processing plants which are genuinely interested in the state as a home decide to move forward with establishing operations.

The region depends heavily on nonfarm repayment sources which include a wide array of businesses and salaried income. The state's job market grew over the past twelve months, and South Carolina's index of leading indicators rose during the quarter staying above 100 and pointing to continued growth for the next three to six months as per South Carolina Department of Commerce reports. Unemployment dropped in February by 0.7 percent to 5.7 percent and is down by 2.3 percent since the end of the first quarter 2013. Personal income also increased since year end by 0.5 percent. Given the positive characteristics of the state's economy, prospects remain favorable for continued performance on loans dependent upon nonfarm income.

## ASSOCIATION BALANCE SHEET

The gross loan volume of the Association as of March 31, 2014, was \$1,470,851, a decrease of \$25,702 or 1.72 percent as compared to \$1,496,553 at December 31, 2013. Net loans outstanding at March 31, 2014 were \$1,459,217 as compared to \$1,484,905 at December 31, 2013. Net loans accounted for 94.62 percent of total assets at March 31, 2014, as compared to 93.15 percent of total assets at December 31, 2013.

The decrease in gross loan volume during the reporting period is attributed to payments and payoffs on existing loans exceeding advances on operating funds as well as new term loans. This decrease in gross volume in the first quarter is typical for the Association. In 2011, 2012 and 2013, gross volume decreased 1.30 percent, 2.54 percent and 3.01 percent, respectively. Commercial bank competition for good, quality loans continues to be a challenge for the lending staff as it has increased substantially within the Association's territory.

The Association typically structures loans to meet the needs of the borrower. Many term loans are made for ten years or less allowing the borrower to build equity faster and thus reducing the risk in the loan portfolio.

At December 31, 2013, the Association held Investment securities totaling \$7,193. These investments are Rural America bonds made under the authority for Mission Related Investments granted by the Farm Credit Administration. At March 31, 2014, investment securities totaled \$12,128, an increase of \$4,935. The 68.61 percent increase is from a new investment purchased in the first quarter of 2014.

There is an inherent risk in the extension of any type of credit. Portfolio credit quality continues to be maintained at an acceptable level and credit administration remains satisfactory. Nonaccrual loans decreased from \$20,071 at December 31, 2013, to \$19,286 at March 31, 2014. The balance of nonaccrual loans is reduced by liquidations, returning loans to accrual status, or transferring assets to other property owned. These activities exceeded any transfers to nonaccrual status during the quarter ending March 31, 2014. Association staff is working diligently to work out all nonaccrual debt situations, and additional transfers may occur as the economy remains sluggish.

Other property owned increased to \$1,962 at March 31, 2014 from \$1,731 at December 31, 2013. The increase of \$231 or 13.34 percent in other property owned is the result of transfers to other property owned exceeding the sale or write down of property during the reporting period. The Association is actively marketing all properties for sale. For details, please visit our website at [www.agsouthfc.com](http://www.agsouthfc.com) and click on Property For Sale.

Association management maintains an allowance for loan losses in an amount considered sufficient to absorb possible losses in the loan portfolio based on current and expected future conditions. The allowance for loan losses at March 31, 2014, was \$11,634 compared to \$11,648 at December 31, 2013, and was considered by management to be adequate to cover possible losses. The slight decrease in the allowance account is the result of a provision adjustment to other liabilities to cover potential losses on undrawn commitment. The Asset/Liability Committee (ALCO) of the Association, which is comprised of members of senior management and staff assigned to special assets management, met in March to review the allowance account. The ALCO determined that an addition to the allowance account was not needed at this time but that additional funds were needed to be set aside for potential losses on undrawn commitment balances which increased during the reporting period. The ALCO considered the general economic conditions, the potential for further deterioration in the existing portfolio and the possibility for some loan growth in the next quarter in determining the level of allowance.

Premises and equipment, net decreased \$1 from \$15,894 at December 31, 2013 to \$15,893 at March 31, 2014. The decrease is the result of normal activity within the premises and equipment accounts.

The Accounts receivable amount decreased \$24,781 from \$28,008 at December 31, 2013 to \$3,227 at March 31, 2014. This line item includes the accrual of patronage income year to date from AgFirst to the Association. As of March 31, 2014 only one quarter of accrual had been recorded. On the liability side of the balance sheet, Patronage refunds payable decreased \$8,166 from \$8,799 at December 31, 2013 to \$633 at March 31, 2014. The decrease is from the check process which moved the final amount to the Other Liabilities line item as the checks for the amounts payable were produced in March.

Accounts payable decreased \$942 from \$1,674 at December 31, 2013 to \$732 at March 31, 2014. The 56.27 percent decrease is due to the payable established to pay the insurance premiums on loans to the FCSIC. At December 31, 2013, this payable was \$1,147 and at March 31, 2014 the payable had been reduced to \$331 due to the cash payment made in January 2014.

Other liabilities increased \$4,681 from \$23,774 at December 31, 2013 to \$28,455 at March 31, 2014. The 19.69 percent increase is due to the liability to pay the cash portion of the 2013 patronage distribution.

Protected borrower stock decreased from \$16 at December 31, 2013 to \$5 at March 31, 2014. In October 2013, the Association's board of directors elected to retire the remaining protected borrower stock where possible.

Unallocated surplus increased \$7,930 or 4.71 percent. The balance of \$176,332 at March 31, 2014 includes the retention of 2013 fiscal year end earnings.

## RESULTS OF OPERATIONS

### *For the three months ended March 31, 2014*

Net income for the three months ended March 31, 2014, totaled \$8,834 as compared to \$8,798 for the same period in 2013. This is an increase of \$36 or less than one percent. The commentary below explains the variance.

At March 31, 2014, interest income increased \$193 from \$21,735 at March 31, 2013 to \$21,928. This increase of less than one percent is primarily due to the collection of interest income on several nonaccrual loans that were reinstated to accruing status or paid out during the accounting period. Nonaccrual income, which is included in interest income, was \$354 for the three months ended March 31, 2014, as compared to \$25 for the same period in 2013.

Interest expense for the three months ended March 31, 2014 decreased \$433 from \$7,952 at March 31, 2013 to \$7,519 at March 31, 2014. The decrease is tied to the lower Notes Payable balance and the lower interest rate environment.

Net interest income before the provision for loan loss increased \$626 for the three months ended March 31, 2014, as compared to the same period in 2013 due primarily to the increase in interest income as discussed above. Net interest income after the provision for loan losses increased \$476 during the quarter ending March 31, 2014.

A small reversal of the provision was made in the quarter ending March 31, 2013. The reversal was necessary to move general allowance to Other Liabilities to cover potential losses on undrawn loan commitment. In the same period in 2014, no provision entry was necessary.

Noninterest income decreased \$754 over the same period last year. Loan fees decreased \$335 or 37.1 percent. The loan fee variance can be tied to the decrease in demand for loans sold on the secondary market. The volume of loans sold decreased between the two reporting periods due to the weak purchased market and the lack of refinancing due to a higher interest rate environment. These two events in the secondary mortgage market caused a decline in secondary mortgage market activity resulting in lower fee income.

Fees for financially related services decreased \$87 from \$284 at March 31, 2013 compared to \$197 at March 31, 2014. The decrease of 30.63 percent is due to timing of collection of commissions from the sale of multi-peril insurance and an experience refund from the sale of life insurance between the two reporting periods.

Patronage refunds from other Farm Credit institutions increased \$25 from \$2,739 at March 31, 2013 to \$2,764 at March 31, 2014. This is an increase of less than one percent and is the result of higher patronage refunds earned from other Farm Credit entities for loans sold for the quarter ending March 31, 2014 when compared to March 31, 2013.

Gains on the sale of rural home loans decreased \$294 from \$460 at March 31, 2013 compared to \$166 at March 31, 2014. The decrease is the result of the decrease in originations between the two reporting periods. Demand for home loans has declined due to the weak purchase market and the higher interest rate environment which has slowed refinance activity.

There were no gains or losses on the sale of premises and equipment for the period ending March 31, 2014. During the March 31, 2013 quarter, the Association recorded gains on the sale of several Association automobiles that were replaced. These gains totaled \$17.

Other noninterest income was \$163 during the three months ended March 31, 2014, compared to \$232 for the three months ending March 31, 2013. During the 2013 reporting period, the Association booked a contingent liability for potential losses on Unfunded Commitment loan balances. The entry for the quarter ending March 31, 2014 was less than the 2013 entry.

Noninterest expense for the three months ended March 31, 2014, decreased \$290 or 3.01 percent when compared to the same period of 2013. Salaries and employee benefit expense decreased \$111 between the two reporting periods. The decrease in salaries and employee benefits is due to the reduction in commissions paid for secondary mortgage market activity.

Occupancy and equipment expense at March 31, 2014 was \$700 compared to \$672 for the same period in 2013. The increase of \$28 is the result of maintenance and repairs completed in the 2014 time frame.

The Insurance Fund premium increased \$53 from \$278 at March 31, 2013 to \$331 at March 31, 2014. The variance is due to the higher premium on both accruing and nonaccruing loans assessed in 2014 by the Insurance Fund.

In the three months ending March 31, 2014, the Association experienced losses and expenses on the sale of Other Property Owned in the amount of \$23. During the same period of 2013, the Association booked losses and expenses on the sale of Other Property Owned of \$257. The losses and expenses in the 2013 reporting period were an accumulation of write downs on several pieces of Other Property Owned held by the Association as well as losses recorded at the time of the sale. Some pieces are under contract for less than the current carrying value, while other write downs were needed due to new appraisals. The inventory of Other Property owned has decreased substantially since the 2013 reporting period and expenses and losses have not been as prevalent in the 2014 reporting period.

Other operating expenses decreased \$26 from \$1,804 at March 31, 2013, compared to \$1,778 at March 31, 2014. The decrease of 1.44 percent is attributed to a decrease in purchased services, printing and office supplies, supervisory and examination expenses between the reporting periods. The Association continues to experience higher travel expense due to the increase in the cost of operating Association automobiles. Other operating expenses also include communications, data processing, and all other expenses necessary to run the business.

## FUNDING SOURCES

The principal source of funds for the Association is the borrowing relationship established with AgFirst Farm Credit Bank (the Bank) through a General Financing Agreement. The General Financing Agreement utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The Bank advances the funds to the Association in the form of notes payable. The notes payable are segmented into variable rate and fixed rate sections. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association. The total notes payable to the Bank at March 31, 2014 was \$1,215,490 as compared to \$1,271,311 at December 31, 2013. The decline in the notes payable correlates to the decrease in gross loans during the reporting period.

See Note 5 in the Notes to the Consolidated Financial Statements for information on the status of compliance with covenants under the General Financing Agreement.

## CAPITAL RESOURCES

Total members' equity at December 31, 2013 totaled \$285,777. At March 31, 2014 total member's equity had increased by \$8,552 to \$294,329. The increase is tied to the increase in unallocated retained earnings between the two reporting periods. At December 31, 2013, allocated retained earnings totaled \$110,391. At March 31, 2014, the allocated retained earnings had increased to \$110,952. Unallocated equities increased \$7,930 from \$168,402 at December 31, 2013 to \$176,332 at March 31, 2014. The increase is the result of earnings retained for capital purposes at year end 2013 and year to date earnings in 2014.

Total capital stock and participation certificates were \$7,264 on March 31, 2014, compared to \$7,208 on December 31, 2013. The increase is attributed to the purchase of new stock and participation certificates for new borrowing entities offset by the retirement of stock and participation certificates on loans liquidated in the normal course of business.

Farm Credit Administration (FCA) regulations require all Farm Credit institutions to maintain minimum permanent capital, total surplus, and core surplus ratios. These ratios are calculated by dividing the Association's permanent capital, total surplus, and core surplus, as defined in FCA regulations, by a risk-adjusted asset base. As of March 31, 2014, the Association's total surplus ratio and core surplus ratio were 19.06 percent and 13.90 percent, respectively, and the permanent capital ratio was 19.57 percent. All three ratios were well above the minimum regulatory ratios of 7.00 percent for permanent capital and total surplus ratios and 3.50 percent for the core surplus ratio.

The Association has a portion of the portfolio in an in-portfolio guarantee program with Farmer Mac. The purpose of these guarantees is to improve the Association's capital position. At March 31, 2014, the Association had loans totaling \$22,767 in this program. The cost of the guarantees year to date was \$32. The use of the Farmer Mac in-portfolio guarantee has a positive effect on the Association's capital ratios.

At the present time, the Association's capital position remains strong and well above regulatory minimums. At December 31, 2013, the Association's permanent capital ratio was 18.69 percent. The increase to 19.57 percent permanent capital at March 31, 2014 is the result of the Association's decision to retain income in unallocated surplus, the limited growth on the balance sheet, and the use of various loan guarantee programs, including FSA, SBA and Farmer Mac. The Association has other tools available to strengthen the capital position. These options include selling additional loans to AgFirst and others, placing additional pools of loans with Farmer Mac in the in-portfolio guarantee program, and participating with AgFirst in a capitalized participation pool. Should additional measures be needed to improve the Association's capital ratios, Association management will study all options and make a recommendation to the Board for consideration.

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## REGULATORY MATTERS

On October 11, 2012, the Board entered into a Supervisory Agreement with the FCA. The Supervisory Agreement requires the Association to take corrective actions with respect to certain areas of its operations including standards of conduct, acquired property, borrower rights and board policies. Conditions and events that led to the need for this agreement include ineffective controls that resulted in the failure to comply with FCA Regulations in the sale of acquired property; violations of FCA Borrower Rights Regulations at 12 C.F.R. Part 612, Subpart G; ineffective controls over board and employee standards of conduct; an inadequate Standards of Conduct program which resulted in violations of FCA Regulations; and a lack of controls regarding standards of conduct for agents. The requirements of this agreement include, but are not limited to:

- Appointment of a new Standards of Conduct Official (SOCO)
- Appointment of a Board Compliance Committee as it relates to the Supervisory Agreement and ongoing Standards of Conduct issues
- Establishment of a standards of conduct program for directors, employees, and agents of the Association which is to include a review of applicable policies and procedures, training for directors and employees and comprehensive audits
- Establishment for a defined process for handling borrower rights issues, including updates to Association policy and procedures
- Policies and procedures revisions and updates around the disposition of other property owned
- Special requirements for properties under contract as of the date of the agreement
- Board approval and certification of future contracts on other properties owned to ensure compliance with FCA Regulations and Association policies and procedures

The Association has developed action plans to correct the weaknesses identified with assignments and due dates. The following action steps are complete as of this writing:

- A Compliance Committee was appointed by the Board of Directors. This committee is comprised of the Board chairman and vice chairman, Audit Committee chairman, and two other directors. The Board chairman will serve as the chairman of the Compliance Committee.
- The Board named Wesley D. Sutton as the Association Standards of Conduct Official. This action was approved by the Director, Risk Supervision Division at the FCA.
- Reports of required task completion outlined in the Supervisory Agreement have been made and published to the Director, Risk Supervision Division.
- Standards of Conduct policies and procedures have been updated, revised, and approved by the Board of Directors.
- Training on Standards of Conduct policies and procedures for all directors and employees has been completed.

- Director disclosures were completed and meetings were held with the SOCO to discuss the same. Following completion of the meetings, the SOCO presented a comprehensive report to the Board.
- Employee disclosures were completed and meetings were held with the SOCO to discuss the same. The SOCO presented a comprehensive report to the Board at the April 2013 meeting.
- Both the Board of Directors and employees completed their subsequent July 2013 and January 2014 disclosures.
- The 4<sup>th</sup> quarter 2012 SOCO report was presented to the Board of Directors at the January 2013 Board meeting.
- The SOCO report was presented quarterly to the Board of Directors at the Board meetings held in January, April, July and October 2013 and January and April 2014.
- A report of acquired property and other borrower's rights activities during each quarter was presented to the Board of Directors at the Board meetings held in January, April, July and October 2013 and January and April 2014.
- The Board adopted a revised Code of Ethics and all board members signed on 8/5/2013. All employees completed the same Code of Ethics as of 8/5/2013.
- An independent accounting firm was hired to complete a comprehensive audit of all acquired property sales from December 31, 2009 forward. The final report was presented to the Board at its' March 2013 meeting. No new exceptions to policy or regulation were identified.
- An independent law firm was hired to complete a comprehensive review of the Association's Standard of Conduct programs for directors, employees and agents, including policies and procedures, training materials, and disclosure documents. The final report was presented to the Board of Directors at the February 2013 Board meeting. Additional suggested revisions to Standards of Conduct policies and procedures have been made and approved by the Board of Directors. A subsequent audit was completed and presented to the Board of Directors at the March 2014 meeting. Additional suggested revisions to Standards of Conduct policies and procedures have been made and will be presented to the Board of Directors at the April 2014 meeting.

Both the Board and Senior Management are committed to continuing the administration of the Association in a safe and sound manner, compliant with all FCA Regulations.

The Association remained under written Supervisory Agreement as of the date of this report.

On March 31, 2014, the FCA published an interim final rule rescinding all requirements for nonbinding advisory votes on senior officer compensation at System banks and associations. The comment period for the interim rule ended on April 30, 2014. A final effective date for the rule has not yet been published.



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**RECENTLY ISSUED ACCOUNTING  
PRONOUNCEMENTS**

Please refer to Note 1, “*Organization, Significant Accounting Policies, and Recently Issued Accounting Pronouncements*”, in the Notes to the Financial Statements, and the 2013 Annual Report to Shareholders for recently issued accounting pronouncements.

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**NOTE:** Shareholder investment in the Association is materially affected by the financial condition and results of operations of AgFirst Farm Credit Bank. Copies of AgFirst’s annual and quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 2832, or writing Susanne Caughman, AgFirst Farm Credit Bank, P.O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained at their website, [www.agfirst.com](http://www.agfirst.com). Copies of the Association’s annual and quarterly reports are also available upon request free of charge by calling 1-800-310-4805, ext. 6737, writing Alisa D. Gunter, CFO, AgSouth Farm Credit, ACA, PO Box 4966, Spartanburg, SC 29305, or accessing the website [www.agsouthfc.com](http://www.agsouthfc.com). The Association prepares an electronic version of the Annual Report which is available on the Association’s web site within 75 days after the end of the fiscal year and distributes the Annual report to Shareholders within 90 days after the end of the fiscal year. The Association prepares an electronic version of the Quarterly report within 40 days after the end of each fiscal quarter, except that no report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution.

# AgSouth Farm Credit, ACA

## Consolidated Balance Sheets

<i>(dollars in thousands)</i>	<b>March 31, 2014</b>	<b>December 31, 2013</b>
	<i>(unaudited)</i>	<i>(audited)</i>
<b>Assets</b>		
Cash	\$ 2,194	\$ 7,061
Investment securities:		
Held to maturity (fair value of \$12,022 and \$7,132, respectively)	12,128	7,193
Loans	1,470,851	1,496,553
Allowance for loan losses	(11,634)	(11,648)
Net loans	1,459,217	1,484,905
Loans held for sale	780	535
Accrued interest receivable	13,367	14,148
Investments in other Farm Credit institutions	21,423	21,507
Premises and equipment, net	15,893	15,894
Other property owned	1,962	1,731
Accounts receivable	3,227	28,008
Other assets	11,989	13,154
Total assets	<b>\$ 1,542,180</b>	<b>\$ 1,594,136</b>
<b>Liabilities</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 1,215,490	\$ 1,271,311
Accrued interest payable	2,541	2,801
Patronage refunds payable	633	8,799
Accounts payable	732	1,674
Other liabilities	28,455	23,774
Total liabilities	<b>1,247,851</b>	<b>1,308,359</b>
Commitments and contingencies		
<b>Members' Equity</b>		
Protected borrower stock	5	16
Capital stock and participation certificates	7,259	7,192
Retained earnings		
Allocated	110,952	110,391
Unallocated	176,332	168,402
Accumulated other comprehensive income (loss)	(219)	(224)
Total members' equity	<b>294,329</b>	<b>285,777</b>
Total liabilities and members' equity	<b>\$ 1,542,180</b>	<b>\$ 1,594,136</b>

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

# AgSouth Farm Credit, ACA

## Consolidated Statements of Income

(unaudited)

<i>(dollars in thousands)</i>	<b>For the three months ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
<b>Interest Income</b>		
Loans	\$ 21,760	\$ 21,671
Investment securities	168	64
Total interest income	21,928	21,735
<b>Interest Expense</b>		
Notes payable to AgFirst Farm Credit Bank	7,515	7,948
Other	4	4
Total interest expense	7,519	7,952
Net interest income	14,409	13,783
Provision for (reversal of allowance for) loan losses	—	(150)
Net interest income after provision for (reversal of allowance for) loan losses	14,409	13,933
<b>Noninterest Income</b>		
Loan fees	568	903
Fees for financially related services	197	284
Patronage refunds from other Farm Credit institutions	2,764	2,739
Gains (losses) on sales of rural home loans, net	166	460
Gains (losses) on sales of premises and equipment, net	—	17
Gains (losses) on other transactions	(98)	(121)
Other noninterest income	163	232
Total noninterest income	3,760	4,514
<b>Noninterest Expense</b>		
Salaries and employee benefits	6,503	6,614
Occupancy and equipment	700	672
Insurance Fund premiums	331	278
(Gains) losses on other property owned, net	23	257
Other operating expenses	1,778	1,804
Total noninterest expense	9,335	9,625
Income before income taxes	8,834	8,822
Provision for income taxes	—	24
Net income	\$ 8,834	\$ 8,798

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

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AgSouth Farm Credit, ACA

# Consolidated Statements of Comprehensive Income

*(unaudited)*

<i>(dollars in thousands)</i>	For the three months ended March 31,	
	2014	2013
Net income	\$ 8,834	\$ 8,798
<b>Other comprehensive income net of tax</b>		
Employee benefit plans adjustments	5	22
Comprehensive income	\$ 8,839	\$ 8,820

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

**AgSouth Farm Credit, ACA**  
**Consolidated Statements of Changes in**  
**Members' Equity**

*(unaudited)*

<i>(dollars in thousands)</i>	Protected Borrower Stock	Capital Stock and Participation Certificates	Retained Earnings		Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
			Allocated	Unallocated		
Balance at December 31, 2012	\$ 78	\$ 7,030	\$ 113,193	\$ 146,871	\$ (607)	\$ 266,565
Comprehensive income				8,798	22	8,820
Protected borrower stock issued/(retired), net	(15)					(15)
Capital stock/participation certificates issued/(retired), net		(20)				(20)
Retained earnings retired			(13)			(13)
Patronage distribution adjustment			(24)	34		10
<b>Balance at March 31, 2013</b>	<b>\$ 63</b>	<b>\$ 7,010</b>	<b>\$ 113,156</b>	<b>\$ 155,703</b>	<b>\$ (585)</b>	<b>\$ 275,347</b>
Balance at December 31, 2013	\$ 16	\$ 7,192	\$ 110,391	\$ 168,402	\$ (224)	\$ 285,777
Comprehensive income				8,834	5	8,839
Protected borrower stock issued/(retired), net	(11)					(11)
Capital stock/participation certificates issued/(retired), net		67				67
Retained earnings retired			(72)			(72)
Patronage distribution adjustment			633	(904)		(271)
<b>Balance at March 31, 2014</b>	<b>\$ 5</b>	<b>\$ 7,259</b>	<b>\$ 110,952</b>	<b>\$ 176,332</b>	<b>\$ (219)</b>	<b>\$ 294,329</b>

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

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*AgSouth Farm Credit, ACA*

# Notes to the Consolidated Financial Statements

*(dollars in thousands, except as noted)  
(unaudited)*

## **Note 1 — Organization, Significant Accounting Policies, and Recently Issued Accounting Pronouncements**

### **Organization**

The accompanying financial statements include the accounts of AgSouth Farm Credit, ACA (the Association). A description of the organization and operations, the significant accounting policies followed, and the financial condition and results of operations for the Association as of and for the year ended December 31, 2013, are contained in the 2013 Annual Report to Shareholders. These unaudited interim consolidated financial statements should be read in conjunction with the latest Annual Report to Shareholders.

### **Basis of Presentation**

In the opinion of management, 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 (GAAP) and prevailing practices within the banking industry.

Certain amounts in the prior period's consolidated financial statements may have been reclassified to conform to the current period presentation. Such reclassifications had no effect on the prior period net income or total capital as previously reported.

The results of any interim period are not necessarily indicative of the results to be expected for a full year.

### **Significant Accounting Policies**

The Association maintains an allowance for loan losses at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio as of the report date. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through loan charge-offs and allowance reversals. A review of individual loans in each respective portfolio is performed periodically to determine the appropriateness of risk ratings and to ensure loss exposure to the Association has been identified.

### **Recently Issued Accounting Pronouncements**

In March 2014 The Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-06, "Technical Corrections and Improvements Related to Glossary

Terms (Master Glossary)." The amendments in this Update relate to glossary terms, cover a wide range of Topics in the Codification and are presented in four sections: Deletion of Master Glossary Terms, Addition of Master Glossary Term Links, Duplicate Master Glossary Terms, and Other Technical Corrections Related to Glossary Terms. These amendments did not have transition guidance and were effective upon issuance for both public entities and nonpublic entities.

In January 2014 the FASB issued ASU 2014-04, "Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40) - Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure." The objective of the amendments in this Update is to reduce diversity by clarifying when an in substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan receivable should be derecognized and the real estate property recognized. The amendments are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. For entities other than public business entities, the amendments in this Update are effective for annual periods beginning after December 15, 2014, and interim periods within annual periods beginning after December 15, 2015. An entity can elect to adopt the amendments in this Update using either a modified retrospective transition method or a prospective transition method. Early adoption is permitted.

Other recently issued accounting pronouncements are discussed in the 2013 Annual Report to Shareholders.

## **Note 2 — Loans and Allowance for Loan Losses**

For a complete description of the Association's accounting for loans (including impaired loans and the allowance for loan losses) and definitions of loan types, see the 2013 Annual Report to Shareholders.

Credit risk arises from the potential inability of an obligor to meet its repayment obligation. The Association manages credit risk associated with lending activities through an assessment of the credit risk profile of an individual obligor. The Association sets its own underwriting standards and lending policies that provide direction to loan officers and are approved by the board of directors.

A summary of loans outstanding at period end follows:

	March 31, 2014	December 31, 2013
Real estate mortgage	\$ 1,201,274	\$ 1,206,662
Production and intermediate-term	217,328	238,212
Processing and marketing	6,145	4,458
Farm-related business	8,272	9,501
Rural residential real estate	37,278	37,160
Other (including Mission Related)	554	560
<b>Total Loans</b>	<b>\$ 1,470,851</b>	<b>\$ 1,496,553</b>

A substantial portion of the Association's lending activities is collateralized, and exposure to credit loss associated with lending activities is reduced accordingly.

The Association may purchase or sell participation interests with other parties in order to diversify risk, manage loan volume, and comply with Farm Credit Administration (FCA) regulations. The following tables present participation loan balances at periods ended:

	March 31, 2014							
	Within AgFirst District		Within Farm Credit System		Outside Farm Credit System		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
Real estate mortgage	\$ 426	\$ 98,297	\$ -	\$ 13,509	\$ -	\$ 8,531	\$ 426	\$ 120,338
Production and intermediate-term	-	57,168	1,033	-	1,615	40	2,648	57,208
Processing and marketing	-	7,109	-	8,004	-	-	-	15,113
Farm-related business	-	833	-	-	-	-	-	833
<b>Total</b>	<b>\$ 426</b>	<b>\$ 163,407</b>	<b>\$ 1,033</b>	<b>\$ 21,513</b>	<b>\$ 1,615</b>	<b>\$ 8,571</b>	<b>\$ 3,074</b>	<b>\$ 193,492</b>

	December 31, 2013							
	Within AgFirst District		Within Farm Credit System		Outside Farm Credit System		Total	
	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold	Participations Purchased	Participations Sold
Real estate mortgage	\$ 436	\$ 113,058	\$ -	\$ 7,117	\$ -	\$ -	\$ 436	\$ 120,175
Production and intermediate-term	-	64,867	1,089	-	1,668	40	2,757	64,907
Processing and marketing	-	7,499	-	6,770	-	-	-	14,269
Farm-related business	-	5,417	-	-	-	-	-	5,417
<b>Total</b>	<b>\$ 436</b>	<b>\$ 190,841</b>	<b>\$ 1,089</b>	<b>\$ 13,887</b>	<b>\$ 1,668</b>	<b>\$ 40</b>	<b>\$ 3,193</b>	<b>\$ 204,768</b>

A significant source of liquidity for the Association is the repayments and maturities of loans. The following table presents the contractual maturity distribution of loans by loan type at the latest period end:

	March 31, 2014			
	Due less than 1 year	Due 1 Through 5 years	Due after 5 years	Total
Real estate mortgage	\$ 83,400	\$ 252,340	\$ 865,533	\$ 1,201,274
Production and intermediate-term	84,685	90,870	41,773	217,328
Processing and marketing	2,750	740	2,655	6,145
Farm-related business	1,237	3,554	3,481	8,272
Rural residential real estate	4,662	3,618	28,998	37,278
Other (including Mission Related)	-	-	554	554
<b>Total Loans</b>	<b>\$ 176,734</b>	<b>\$ 351,122</b>	<b>\$ 942,994</b>	<b>\$ 1,470,851</b>
<b>Percentage</b>	<b>12.02%</b>	<b>23.87%</b>	<b>64.11%</b>	<b>100.00%</b>

The following table shows loans and related accrued interest, classified under the FCA Uniform Loan Classification System, as a percentage of total loans and related accrued interest receivable by loan type as of:

	March 31, 2014	December 31, 2013		March 31, 2014	December 31, 2013
<b>Real estate mortgage:</b>			<b>Farm-related business:</b>		
Acceptable	94.49%	94.34%	Acceptable	99.69%	94.25%
OAEM	2.93	3.09	OAEM	0.24	5.68
Substandard/doubtful/loss	2.58	2.57	Substandard/doubtful/loss	0.07	0.07
	<u>100.00%</u>	<u>100.00%</u>		<u>100.00%</u>	<u>100.00%</u>
<b>Production and intermediate-term:</b>			<b>Rural residential real estate:</b>		
Acceptable	92.90%	93.65%	Acceptable	97.45%	97.07%
OAEM	3.41	2.60	OAEM	1.13	1.16
Substandard/doubtful/loss	3.69	3.75	Substandard/doubtful/loss	1.42	1.77
	<u>100.00%</u>	<u>100.00%</u>		<u>100.00%</u>	<u>100.00%</u>
<b>Processing and marketing:</b>			<b>Other (including Mission Related):</b>		
Acceptable	100.00%	100.00%	Acceptable	100.00%	100.00%
OAEM	—	—	OAEM	—	—
Substandard/doubtful/loss	—	—	Substandard/doubtful/loss	—	—
	<u>100.00%</u>	<u>100.00%</u>		<u>100.00%</u>	<u>100.00%</u>
			<b>Total Loans:</b>		
			Acceptable	94.38%	94.31%
			OAEM	2.93	2.97
			Substandard/doubtful/loss	2.69	2.72
				<u>100.00%</u>	<u>100.00%</u>

The following tables provide an age analysis of past due loans and related accrued interest as of:

	March 31, 2014					
	30 Through 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 or More Past Due and Accruing Interest
Real estate mortgage	\$ 8,554	\$ 4,320	\$ 12,874	\$ 1,198,782	\$ 1,211,656	\$ 25
Production and intermediate-term	733	4,231	4,964	214,941	219,905	—
Processing and marketing	—	—	—	6,188	6,188	—
Farm-related business	—	1	1	8,337	8,338	—
Rural residential real estate	197	86	283	37,196	37,479	—
Other (including Mission Related)	—	—	—	556	556	—
Total	<u>\$ 9,484</u>	<u>\$ 8,638</u>	<u>\$ 18,122</u>	<u>\$ 1,466,000</u>	<u>\$ 1,484,122</u>	<u>\$ 25</u>

	December 31, 2013					
	30 Through 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 or More Past Due and Accruing Interest
Real estate mortgage	\$ 6,908	\$ 4,379	\$ 11,287	\$ 1,205,879	\$ 1,217,166	\$ —
Production and intermediate-term	4,021	906	4,927	236,606	241,533	—
Processing and marketing	—	—	—	4,487	4,487	—
Farm-related business	—	1	1	9,603	9,604	—
Rural residential real estate	549	198	747	36,576	37,323	—
Other (including Mission Related)	—	—	—	561	561	—
Total	<u>\$ 11,478</u>	<u>\$ 5,484</u>	<u>\$ 16,962</u>	<u>\$ 1,493,712</u>	<u>\$ 1,510,674</u>	<u>\$ —</u>

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



Nonperforming assets (including related accrued interest) and related credit quality statistics at period end were as follows:

	March 31, 2014	December 31, 2013
<b>Nonaccrual loans:</b>		
Real estate mortgage	\$ 12,439	\$ 12,944
Production and intermediate-term	6,363	6,517
Loans to cooperatives	-	-
Processing and marketing	-	-
Farm-related business	6	7
Rural residential real estate	478	603
Total nonaccrual loans	<u>\$ 19,286</u>	<u>\$ 20,071</u>
<b>Accruing restructured loans:</b>		
Real estate mortgage	\$ 13,172	\$ 12,751
Production and intermediate-term	1,045	1,038
Farm-related business	194	196
Total accruing restructured loans	<u>\$ 14,411</u>	<u>\$ 13,985</u>
<b>Accruing loans 90 days or more past due:</b>		
Real estate mortgage	\$ 25	\$ -
Production and intermediate-term	-	-
Rural residential real estate	-	-
Total accruing loans 90 days or more past due	<u>\$ 25</u>	<u>\$ -</u>
Total nonperforming loans	\$ 33,722	\$ 34,056
Other property owned	1,962	1,731
Total nonperforming assets	<u>\$ 35,684</u>	<u>\$ 35,787</u>
Nonaccrual loans as a percentage of total loans	1.31%	1.34%
Nonperforming assets as a percentage of total loans and other property owned	2.42%	2.39%
Nonperforming assets as a percentage of capital	12.12%	12.52%

The following table presents information relating to impaired loans (including accrued interest) at period end. Impaired loans are loans for which it is probable that all principal and interest will not be collected according to the contractual terms of the loan.

	March 31, 2014	December 31, 2013
<b>Impaired nonaccrual loans:</b>		
Current as to principal and interest	\$ 9,203	\$ 9,249
Past due	10,083	10,822
Total impaired nonaccrual loans	<u>19,286</u>	<u>20,071</u>
<b>Impaired accrual loans:</b>		
Restructured	14,411	13,985
90 days or more past due	25	-
Total impaired accrual loans	<u>14,436</u>	<u>13,985</u>
Total impaired loans	<u>\$ 33,722</u>	<u>\$ 34,056</u>

The following tables present additional impaired loan information at period end. Unpaid principal balance represents the contractual principal balance of the loan.

	March 31, 2014			Quarter Ended March 31, 2014	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Loans	Interest Income Recognized on Impaired Loans
<b>Impaired loans with a related allowance for credit losses:</b>					
Real estate mortgage	\$ 678	\$ 723	\$ 78	\$ 677	\$ 10
Production and intermediate-term	79	79	3	79	1
Processing and marketing	—	—	—	—	—
Farm-related business	—	—	—	—	—
Rural residential real estate	—	—	—	—	—
Total	\$ 757	\$ 802	\$ 81	\$ 756	\$ 11
<b>Impaired loans with no related allowance for credit losses:</b>					
Real estate mortgage	\$ 24,958	\$ 27,786	\$ —	\$ 24,920	\$ 372
Production and intermediate-term	7,329	9,300	—	7,318	109
Processing and marketing	—	—	—	—	—
Farm-related business	200	223	—	200	3
Rural residential real estate	478	605	—	478	7
Total	\$ 32,965	\$ 37,914	\$ —	\$ 32,916	\$ 491
<b>Total impaired loans:</b>					
Real estate mortgage	\$ 25,636	28,509	78	\$ 25,597	\$ 382
Production and intermediate-term	7,408	9,379	3	7,397	110
Processing and marketing	—	—	—	—	—
Farm-related business	200	223	—	200	3
Rural residential real estate	478	605	—	478	7
Total	\$ 33,722	\$ 38,716	\$ 81	\$ 33,672	\$ 502
<b>December 31, 2013</b>					
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Loans	Interest Income Recognized on Impaired Loans
<b>Impaired loans with a related allowance for credit losses:</b>					
Real estate mortgage	\$ 704	\$ 1,028	\$ 295	\$ 629	\$ 43
Production and intermediate-term	113	211	56	102	7
Farm-related business	—	—	—	—	—
Rural residential real estate	—	—	—	—	—
Total	\$ 817	\$ 1,239	\$ 351	\$ 731	\$ 50
<b>Impaired loans with no related allowance for credit losses:</b>					
Real estate mortgage	\$ 24,991	\$ 27,739	\$ —	\$ 22,363	\$ 1,525
Production and intermediate-term	7,442	9,336	—	6,659	454
Farm-related business	203	226	—	181	12
Rural residential real estate	603	719	—	539	37
Total	\$ 33,239	\$ 38,020	\$ —	\$ 29,742	\$ 2,028
<b>Total impaired loans:</b>					
Real estate mortgage	\$ 25,695	\$ 28,767	\$ 295	\$ 22,992	\$ 1,568
Production and intermediate-term	7,555	9,547	56	6,761	461
Farm-related business	203	226	—	181	12
Rural residential real estate	603	719	—	539	37
Total	\$ 34,056	\$ 39,259	\$ 351	\$ 30,473	\$ 2,078

There were no material commitments to lend additional funds to debtors whose loans were classified as impaired at each reporting period. A summary of changes in the allowance for loan losses and recorded investment in loans for each reporting period follows:

	Real Estate Mortgage	Production and Intermediate- term	Agribusiness*	Rural Residential Real Estate	Other (including Mission Related)	Total
<b>Allowance for credit losses:</b>						
Balance at December 31, 2013	\$ 9,397	\$ 1,862	\$ 106	\$ 279	\$ 4	\$ 11,648
Charge-offs	(118)	(34)	(1)	—	—	(153)
Recoveries	57	11	67	—	4	139
Provision for loan losses	174	(124)	(59)	13	(4)	—
Balance at March 31, 2014	\$ 9,510	\$ 1,715	\$ 113	\$ 292	\$ 4	\$ 11,634
Balance at December 31, 2012	\$ 8,008	\$ 2,483	\$ 148	\$ 230	\$ 4	\$ 10,873
Charge-offs	(25)	—	—	—	—	(25)
Recoveries	7	14	1	31	—	53
Provision for loan losses	164	(242)	(43)	(29)	—	(150)
Balance at March 31, 2013	\$ 8,154	\$ 2,255	\$ 106	\$ 232	\$ 4	\$ 10,751
Loans individually evaluated for impairment	\$ 78	\$ 3	\$ —	\$ —	\$ —	\$ 81
Loans collectively evaluated for impairment	9,432	1,712	113	292	4	11,553
Balance at March 31, 2014	\$ 9,510	\$ 1,715	\$ 113	\$ 292	\$ 4	\$ 11,634
Loans individually evaluated for impairment	\$ 295	\$ 56	\$ —	\$ —	\$ —	\$ 351
Loans collectively evaluated for impairment	9,102	1,806	106	279	4	11,297
Balance at December 31, 2013	\$ 9,397	\$ 1,862	\$ 106	\$ 279	\$ 4	\$ 11,648
<b>Recorded investment in loans outstanding:</b>						
Loans individually evaluated for impairment	\$ 12,413	\$ 6,363	\$ 5	\$ 476	\$ —	\$ 19,257
Loans collectively evaluated for impairment	1,199,243	213,542	14,521	37,003	556	1,464,865
Ending balance at March 31, 2014	\$ 1,211,656	\$ 219,905	\$ 14,526	\$ 37,479	\$ 556	\$ 1,484,122
Loans individually evaluated for impairment	\$ 12,938	\$ 6,530	\$ 6	\$ 601	\$ —	\$ 20,075
Loans collectively evaluated for impairment	1,204,228	235,003	14,085	36,722	561	1,490,599
Ending balance at December 31, 2013	\$ 1,217,166	\$ 241,533	\$ 14,091	\$ 37,323	\$ 561	\$ 1,510,674

\*Includes the loan types; Loans to cooperatives, Processing and marketing, and Farm-related business.

A restructuring of a debt constitutes a troubled debt restructuring (TDR) if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. The following tables present additional information about activity that occurred during the periods presented related to TDRs.

Three months ended March 31, 2014						
	Pre-modification Outstanding Recorded Investment				Total	Effects of Modification
	Interest Concessions	Principal Concessions	Other Concessions			
<b>Troubled debt restructurings:</b>						
Real estate mortgage	\$ 292	\$ —	\$ —	\$ —	\$ 292	\$ —
Production and intermediate-term	—	106	—	—	106	—
Total	\$ 292	\$ 106	\$ —	\$ —	\$ 398	\$ —
Three months ended March 31, 2014						
	Post-modification Outstanding Recorded Investment				Total	Effects of Modification
	Interest Concessions	Principal Concessions	Other Concessions			
<b>Troubled debt restructurings:</b>						
Real estate mortgage	\$ 296	\$ —	\$ —	\$ 296	\$ —	\$ —
Production and intermediate-term	—	68	—	68	—	—
Total	\$ 296	\$ 68	\$ —	\$ 364	\$ —	\$ —

Three months ended March 31, 2013				
Pre-modification Outstanding Recorded Investment				
	Interest Concessions	Principal Concessions	Other Concessions	Total
<b>Troubled debt restructurings:</b>				
Real estate mortgage	\$ 2,404	\$ –	\$ –	\$ 2,404
Production and intermediate-term	–	41	–	41
Total	\$ 2,404	\$ 41	\$ –	\$ 2,445

Three months ended March 31, 2013					Effects of Modification
Post-modification Outstanding Recorded Investment					Charge-offs
	Interest Concessions	Principal Concessions	Other Concessions	Total	
<b>Troubled debt restructurings:</b>					
Real estate mortgage	\$ 2,406	\$ –	\$ –	\$ 2,406	\$ –
Production and intermediate-term	–	41	–	41	–
Total	\$ 2,406	\$ 41	\$ –	\$ 2,447	\$ –

Interest concessions may include interest forgiveness and interest deferment. Principal concessions may include principal forgiveness, principal deferment, and maturity extension. Other concessions may include additional compensation received which might be in the form of cash or other assets.

The following table presents outstanding recorded investment for TDRs that occurred during the previous twelve months and for which there was a subsequent payment default during the period. Payment default is defined as a payment that was thirty days or more past due.

	Three Months Ended March 31,	
	2014	2013
<b>Defaulted troubled debt restructurings:</b>		
Real estate mortgage	\$ 136	\$ 79
Production and intermediate-term	21	86
Farm-related business	–	–
Total	\$ 157	\$ 165

The following table provides information on outstanding loans restructured in troubled debt restructurings at period end. These loans are included as impaired loans in the impaired loan table:

	Total TDRs		Nonaccrual TDRs	
	March 31, 2014	December 31, 2013	March 31, 2014	December 31, 2013
Real estate mortgage	\$ 17,538	\$ 18,013	\$ 4,366	\$ 5,262
Production and intermediate-term	3,037	3,028	1,992	1,990
Farm-related business	195	197	1	1
Rural residential real estate	257	261	257	261
Total Loans	\$ 21,027	\$ 21,499	\$ 6,616	\$ 7,514
Additional commitments to lend	\$ –	\$ –		

### Note 3 — Investment Securities

The Association's held-to-maturity investments consist primarily of Rural America Bonds, which are private placement securities purchased under the Mission Related Investment program approved by the FCA. In its Conditions of Approval for the program, the FCA considers a Rural America Bond ineligible if its investment rating, based on the internal 14-point risk rating scale used to also grade loans, falls below 9 and requires System institutions to provide notification to FCA when a security becomes ineligible.

A summary of the amortized cost and fair value of investment securities held-to-maturity follows:

	March 31, 2014				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
Mission Related Investments	\$ 12,128	\$ 103	\$ (209)	\$ 12,022	6.12%

	December 31, 2013				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
Mission Related Investments	\$ 7,193	\$ 35	\$ (96)	\$ 7,132	5.47%

A summary of the contractual maturity, amortized cost and estimated fair value of investment securities held-to-maturity follows:

	March 31, 2014		
	Amortized Cost	Fair Value	Weighted Average Yield
In one year or less	\$ —	\$ —	—%
After one year through five years	3,195	3,086	5.00
After five years through ten years	—	—	—
After ten years	8,933	8,936	6.52
Total	\$ 12,128	\$ 12,022	6.12 %

A portion of these investments have contractual maturities in excess of ten years. However, expected maturities for these types of securities can differ from contractual maturities because borrowers may have the right to prepay obligations with or without prepayment penalties.

An investment is considered impaired if its fair value is less than its cost. A continuous unrealized loss position for an investment is based on the date the impairment was first identified. The following tables show the fair value and gross unrealized losses for investments that were in a continuous unrealized loss position aggregated by investment category.

	March 31, 2014			
	Less than 12 Months		Greater than 12 Months	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mission Related Investments	\$ 7,947	\$ (209)	\$ —	\$ —

	December 31, 2013			
	Less than 12 Months		Greater than 12 Months	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mission Related Investments	\$ 3,098	\$ (96)	\$ —	\$ —

FASB guidance contemplates numerous factors in determining whether an impairment is other-than-temporary. These factors include: (1) whether or not management intends to sell the security, (2) whether it is more likely than not that management would be required to sell the security before recovering its costs, and (3) whether management expects to recover the security's entire amortized cost basis (even if there is no intention to sell). If the Association intends to sell the security or it is more likely than not that it would be required to sell the security, the impairment loss equals the full difference between amortized cost and fair value of the security. When the Association does not intend to sell securities in an unrealized loss position and it is not more likely than not that it would be required to sell the securities, other-than-temporary impairment loss is separated into credit loss and non-credit loss. Credit loss is defined as the shortfall of the present value of the cash flows expected to be collected in relation to the amortized cost basis.

The Association performs periodic credit reviews, including other-than-temporary impairment analyses, on its investment securities portfolio. The objective is to quantify future possible loss of principal or interest due on securities in the portfolio. Factors considered in determining whether an impairment is other-than-temporary include among others: (1) the length of time and the extent to which the fair value is less than cost, (2) adverse conditions specifically related to the industry, (3) geographic area and the condition of the underlying collateral, (4) payment structure of the security, (5) ratings by rating agencies, (6) the credit worthiness of bond insurers, and (7) volatility of the fair value changes.

The Association uses the present value of cash flows expected to be collected from each debt security to determine the amount of credit loss. This technique requires assumptions related to the underlying collateral, including default rates, amount and timing of prepayments, and loss severity. Assumptions can vary widely from security to security and are influenced by such factors as loan interest rate, geographical location of the borrower, borrower characteristics, and collateral type.

Significant inputs used to estimate the amount of credit loss include, but are not limited to, performance indicators of the underlying assets in the security (including default rates, delinquency rates, and percentage of nonperforming assets), loan-to-collateral value ratios, third-party guarantees, current levels of subordination, vintage, geographic concentration, and credit ratings. The Association may obtain assumptions for the default rate, prepayment rate, and loss severity rate from an independent third party, or generate the assumptions internally.

The Association has not recognized any credit losses as any impairments were deemed temporary and resulted from non-credit related factors. The Association has the ability and intent to hold these temporarily impaired investments until a recovery of unrealized losses occurs, which may be at maturity, and at this time expects to collect the full principal amount and interest due on these securities, especially after considering credit enhancements.

#### Note 4 — Debt

##### Notes Payable to AgFirst Farm Credit Bank

The Association's indebtedness to AgFirst Farm Credit Bank (AgFirst or the Bank) represents borrowings by the Association to fund its loan portfolio. This indebtedness is collateralized by a pledge of substantially all of the Association's assets. The contractual terms of the revolving line of credit are contained in the General Financing Agreement (GFA). The GFA also defines Association performance criteria for borrowing from the Bank, which includes borrowing base margin, earnings and capital covenants, among others.

Certain conditions and events that led to the need for the Association to enter into a Supervisory Agreement with the Farm Credit Administration (FCA) as discussed in Note 9, *Regulatory Enforcement Matters*, constituted events of default under the GFA as the Association was not able to remedy the defaults within 30 days of written notice from the Bank. The Bank has waived the Association's events of default under the GFA provided the Association remains compliant with the requirements of the Supervisory Agreement with the FCA.

## Note 5 — Members' Equity

### Accumulated Other Comprehensive Income

The following tables present activity related to AOCI for the periods presented:

	Changes in Accumulated Other Comprehensive Income by Component (a)	
	Three Months Ended March 31,	
	2014	2013
<b>Employee Benefit Plans:</b>		
Balance at beginning of period	\$ (224)	\$ (607)
Other comprehensive income before reclassifications	—	—
Amounts reclassified from AOCI	5	22
Net current period other comprehensive income	5	22
Balance at end of period	\$ (219)	\$ (585)

	Reclassifications Out of Accumulated Other Comprehensive Income (b)		
	Three Months Ended March 31,		
	2014	2013	Income Statement Line Item
<b>Defined Benefit Pension Plans:</b>			
Periodic pension costs	\$ (5)	\$ (22)	See footnote 7.
Net amounts reclassified	\$ (5)	\$ (22)	

(a) Amounts in parentheses indicate debits to AOCI.

(b) Amounts in parentheses indicate debits to profit/loss.

## Note 6 — Fair Value Measurement

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability.

Accounting guidance establishes a hierarchy for disclosure of fair value measurements to maximize the use of observable inputs, that is, inputs that reflect the assumptions market participants would use in pricing an asset or liability based on market data obtained from sources independent of the reporting entity. The hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. A financial instrument's categorization within the hierarchy tiers is based upon the lowest level of input that is significant to the fair value measurement.

Estimating the fair value of the Association's investment in the Bank and Other Farm Credit Institutions is not practicable because the stock is not traded. The net investment is a requirement of borrowing from the Bank and is carried at cost plus allocated equities in the accompanying Consolidated

Balance Sheets. The Association owns 6.90 percent of the issued stock of the Bank as of March 31, 2014 net of any reciprocal investment. As of that date, the Bank's assets totaled \$27.6 billion and shareholders' equity totaled \$2.2 billion. The Bank's earnings were \$88 million for the first three months of 2014. In addition, the Association has an investment of \$3,763 related to other Farm Credit institutions.

The classifications within the fair value hierarchy are as follows:

### Level 1

Level 1 inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets.

### Level 2

Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets; quoted prices in markets that are not active; and inputs that are observable, or can be corroborated, for substantially the full term of the asset or liability.

### Level 3

Level 3 inputs to the valuation methodology are unobservable and supported by little or no market activity. Valuation is determined using pricing models, discounted cash flow methodologies, or similar techniques, and could include significant management judgment or estimation. Level 3 assets and liabilities also could include instruments whose price has been adjusted based on dealer quoted pricing that is different than the third-party valuation or internal model pricing.

For a complete discussion of the inputs and other assumptions considered in assigning various assets and liabilities to the fair value hierarchy levels, see the latest Annual Report to Shareholders.

The following tables present the changes in Level 3 assets and liabilities measured at fair value on a recurring basis for the periods presented. The Association had no transfers of assets or liabilities into or out of Level 1 or Level 2 during the periods presented.

	Standby Letters of Credit	
	For the three months ended March 31,	
	2014	2013
Balance at beginning of period	\$ 2	\$ 5
Issuances	3	2
Settlements	—	—
Balance at end of period	\$ 5	\$ 7

### SENSITIVITY TO CHANGES IN SIGNIFICANT UNOBSERVABLE INPUTS

Discounted cash flow or similar modeling techniques are generally used to determine the recurring fair value measurements for Level 3 assets and liabilities. Use of these techniques requires determination of relevant inputs and assumptions, some of which represent significant unobservable inputs as indicated in the tables that follow. Accordingly, changes in these unobservable inputs may have a significant impact on fair value.

Certain of these unobservable inputs will (in isolation) have a directionally consistent impact on the fair value of the instrument for a given change in that input. Alternatively, the fair value of the instrument may move in an opposite direction for a given change in another input. Where multiple inputs are used within the valuation technique of an asset or liability, a change in one input in a certain direction may be offset by an opposite change in another input having a potentially muted impact to the overall fair value of that particular instrument. Additionally, a change in one unobservable input may result in a

change to another unobservable input (that is, changes in certain inputs are interrelated with one another), which may counteract or magnify the fair value impact.

### Investment Securities

The fair values of predominantly all level 3 investment securities have consistent inputs, valuation techniques and correlation to changes in underlying inputs. The models used to determine fair value for these instruments use certain significant unobservable inputs within a discounted cash flow or market comparable pricing valuation technique. Such inputs generally include discount rate components including risk premiums, prepayment estimates, default estimates and loss severities.

These level 3 assets would decrease (increase) in value based upon an increase (decrease) in discount rates, defaults, or loss severities. Conversely, the fair value of these assets would generally increase (decrease) in value if the prepayment input were to increase (decrease).

### Other Property Owned/Impaired Loans

Other property owned and impaired loans are valued using appraisals, market comparable sales, replacement costs and income and expense (cash flow) techniques. Certain unobservable inputs are used within these techniques to determine the level 3 fair value of these properties. The significant unobservable inputs are primarily sensitive only to industry, geographic and overall economic conditions, and/or specific attributes of each property.

### Inputs to Valuation Techniques

Management determines the Association's valuation policies and procedures. The Bank performs the majority of the Association's valuations, and its valuation processes are calibrated annually by an independent consultant. The fair value measurements are analyzed on a quarterly basis. For other valuations, documentation is obtained for third party information, such as pricing, and periodically evaluated alongside internal information and pricing that is available.

Quoted market prices are generally not available for the instruments presented below. Accordingly fair values are based on judgments regarding anticipated cash flows, future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates involve uncertainties and matters of judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

### Quantitative Information about Recurring and Nonrecurring Level 3 Fair Value Measurements

	Fair Value	Valuation Technique(s)	Unobservable Input	Range
Impaired loans and other property owned	\$ 35,862	Appraisal	Income and expense	*
			Comparable sales	*
			Replacement cost	*
			Comparability adjustments	*

\* Ranges for this type of input are not useful because each collateral property is unique.

**Information about Other Financial Instrument Fair Value Measurements**

	<b>Valuation Technique(s)</b>	<b>Input</b>
Cash	Carrying Value	Par/Principal and appropriate interest yield
Loans	Discounted cash flow	Prepayment forecasts Probability of default Loss severity
Investment securities, held-to-maturity	Discounted cash flow	Risk adjusted discount rate
Notes payable to AgFirst Farm Credit Bank	Discounted cash flow	Prepayment forecasts Probability of default Loss severity

The following tables present the carrying amounts and fair values of assets and liabilities that are measured at fair value on a recurring and nonrecurring basis, as well as those financial instruments not measured at fair value, for each of the hierarchy levels at the period ended:

<b>At or for the Three Months Ended March 31, 2014</b>						
	<b>Total Carrying Amount</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total Fair Value</b>	<b>Fair Value Effects On Earnings</b>
<b>Recurring Measurements</b>						
<b>Assets:</b>						
Assets held in Trust funds	\$ 1,171	\$ 1,171	\$ –	\$ –	\$ 1,171	
Recurring Assets	\$ 1,171	\$ 1,171	\$ –	\$ –	\$ 1,171	
<b>Liabilities:</b>						
Standby letters of credit	\$ 5	\$ –	\$ –	\$ 5	\$ 5	
Recurring Liabilities	\$ 5	\$ –	\$ –	\$ 5	\$ 5	
<b>Nonrecurring Measurements</b>						
<b>Assets:</b>						
Impaired loans	\$ 33,641	\$ –	\$ –	\$ 33,641	\$ 33,641	\$ 256
Other property owned	1,962	–	–	2,221	2,221	9
Nonrecurring Assets	\$ 35,603	\$ –	\$ –	\$ 35,862	\$ 35,862	\$ 265
<b>Other Financial Instruments</b>						
<b>Assets:</b>						
Cash	\$ 2,194	\$ 2,194	\$ –	\$ –	\$ 2,194	
Investment securities, held-to-maturity	12,128	–	–	12,022	12,022	
Loans	1,426,356	–	–	1,427,597	1,427,597	
Other Financial Assets	\$ 1,440,678	\$ 2,194	\$ –	\$ 1,439,619	\$ 1,441,813	
<b>Liabilities:</b>						
Notes payable to AgFirst Farm Credit Bank	\$ 1,215,490	\$ –	\$ –	\$ 1,203,944	\$ 1,203,944	
Other Financial Liabilities	\$ 1,215,490	\$ –	\$ –	\$ 1,203,944	\$ 1,203,944	

<b>At or for the Year ended December 31, 2013</b>						
	<b>Total Carrying Amount</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total Fair Value</b>	<b>Fair Value Effects On Earnings</b>
<b>Recurring Measurements</b>						
<b>Assets:</b>						
Assets held in Trust funds	\$ 1,003	\$ 1,003	\$ –	\$ –	\$ 1,003	
Recurring Assets	\$ 1,003	\$ 1,003	\$ –	\$ –	\$ 1,003	
<b>Liabilities:</b>						
Standby letters of credit	\$ 2	\$ –	\$ –	\$ 2	\$ 2	
Recurring Liabilities	\$ 2	\$ –	\$ –	\$ 2	\$ 2	
<b>Nonrecurring Measurements</b>						
<b>Assets:</b>						
Impaired loans	\$ 33,705	\$ –	\$ –	\$ 33,705	\$ 33,705	\$ (276)
Other property owned	1,731	–	–	1,920	1,920	(1,647)
Nonrecurring Assets	\$ 35,436	\$ –	\$ –	\$ 35,625	\$ 35,625	\$ (1,923)
<b>Other Financial Instruments</b>						
<b>Assets:</b>						
Cash	\$ 7,061	\$ 7,061	\$ –	\$ –	\$ 7,061	
Investment securities, held-to-maturity	7,193	–	–	7,132	7,132	
Loans	1,451,735	–	–	1,452,649	1,452,649	
Other Financial Assets	\$ 1,465,989	\$ 7,061	\$ –	\$ 1,459,781	\$ 1,466,842	
<b>Liabilities:</b>						
Notes payable to AgFirst Farm Credit Bank	\$ 1,271,311	\$ –	\$ –	\$ 1,257,195	\$ 1,257,195	
Other Financial Liabilities	\$ 1,271,311	\$ –	\$ –	\$ 1,257,195	\$ 1,257,195	



**Note 7 — Employee Benefit Plans**

The following is a table of retirement and other postretirement benefit expenses for the Association:

	For the three months ended March 31,	
	2014	2013
Pension	\$ 1,534	\$ 1,577
401(k)	158	138
Other postretirement benefits	265	256
Total	\$ 1,957	\$ 1,971

The following is a table of retirement and other postretirement benefit contributions for the Association:

	Actual YTD Through 3/31/14	Projected Contributions For Remainder of 2014	Projected Total Contributions 2014
Pension	\$ 21	\$ 4,734	\$ 4,755
Other postretirement benefits	194	619	813
Total	\$ 215	\$ 5,353	\$ 5,568

Contributions in the above table include allocated estimates of funding for multi-employer plans in which the Association participates. These amounts may change when a total funding amount and allocation is determined by the respective Plan’s Sponsor Committee. Also, market conditions could impact discount rates and return on plan assets which could change contributions necessary before the next plan measurement date of December 31, 2014.

Further details regarding employee benefit plans are contained in the 2013 Annual Report to Shareholders.

**Note 8 — Commitments and Contingent Liabilities**

From time to time, legal actions are pending against the Association in which claims for money damages are asserted. On at least a quarterly basis, the Association assesses its liabilities and contingencies in connection with outstanding legal proceedings utilizing the latest information available. While the outcome of legal proceedings is inherently uncertain, on the basis of information presently available, management, after consultation with legal counsel, is of the opinion that the ultimate liability, if any, from these actions, would not be material in relation to the financial position of the Association. Because it is not probable that the Association will incur a loss or the loss is not estimable, no liability has been recorded for any claims that may be pending.

**Note 9 — Regulatory Enforcement Matters**

On October 11, 2012, the Board entered into a Supervisory Agreement with the FCA. The Supervisory Agreement requires the Association to take corrective actions with respect to certain

areas of its operations including standards of conduct, acquired property, borrower rights and board policies. Conditions and events that led to the need for this agreement include ineffective controls that resulted in the failure to comply with FCA Regulations in the sale of acquired property; violations of FCA Borrower Rights Regulations at 12 C.F.R. Part 612, Subpart G; ineffective controls over board and employee standards of conduct; an inadequate Standards of Conduct program which resulted in violations of FCA Regulations; and a lack of controls regarding standards of conduct for agents. The requirements of this agreement include, but are not limited to:

- Appointment of a new Standards of Conduct Official (SOCO)
- Appointment of a Board Compliance Committee as it relates to the Supervisory Agreement and ongoing Standards of Conduct issues
- Establishment of a standards of conduct program for directors, employees, and agents of the Association which is to include a review of applicable policies and procedures, training for directors and employees and comprehensive audits
- Establishment for a defined process for handling borrower rights issues, including updates to Association policy and procedures
- Policies and procedures revisions and updates around the disposition of other property owned
- Special requirements for properties under contract as of the date of the agreement
- Board approval and certification of future contracts on other properties owned to ensure compliance with FCA Regulations and Association policies and procedures

The Association has developed action plans to correct the weaknesses identified with assignments and due dates. The following action steps are complete as of this writing:

- A Compliance Committee was appointed by the Board of Directors. This committee is comprised of the Board chairman and vice chairman, Audit Committee chairman, and two other directors. The Board chairman will serve as the chairman of the Compliance Committee.
- The Board named Wesley D. Sutton as the Association Standards of Conduct Official. This action was approved by the Director, Risk Supervision Division at the FCA.
- Reports of required task completion outlined in the Supervisory Agreement have been made and published to the Director, Risk Supervision Division.
- Standards of Conduct policies and procedures have been updated, revised, and approved by the Board of Directors.
- Training on Standards of Conduct policies and procedures for all directors and employees has been completed.
- Director disclosures were completed and meetings were held with the SOCO to discuss the same. Following completion of the meetings, the SOCO presented a comprehensive report to the Board.

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- Employee disclosures were completed and meetings were held with the SOCO to discuss the same. The SOCO presented a comprehensive report to the Board at the April 2013 meeting.
  - Both the Board of Directors and employees completed their subsequent July 2013 and January 2014 disclosures.
  - The 4<sup>th</sup> quarter 2012 SOCO report was presented to the Board of Directors at the January 2013 Board meeting.
  - The SOCO report was presented quarterly to the Board of Directors at the Board meetings held in January, April, July and October 2013 and January and April 2014.
  - A report of acquired property and other borrower's rights activities during each quarter was presented to the Board of Directors at the Board meetings held in January, April, July and October 2013 and January and April 2014.
  - The Board adopted a revised Code of Ethics and all board members signed on 8/5/2013. All employees completed the same Code of Ethics as of 8/5/2013.
  - An independent accounting firm was hired to complete a comprehensive audit of all acquired property sales from December 31, 2009 forward. The final report was presented to the Board at its' March 2013 meeting. No new exceptions to policy or regulation were identified.
  - An independent law firm was hired to complete a comprehensive review of the Association's Standard of Conduct programs for directors, employees and agents, including policies and procedures, training materials, and disclosure documents. The final report was presented to the Board of Directors at the February 2013 Board meeting. Additional suggested revisions to Standards of Conduct policies and procedures have been made and approved by the Board of Directors. A subsequent audit was completed and presented to the Board of Directors at the March 2014 meeting. Additional suggested revisions to Standards of Conduct policies and procedures have been made and will be presented to the Board of Directors at the April 2014 meeting.

Both the Board and Senior Management are committed to continuing the administration of the Association in a safe and sound manner, compliant with all FCA Regulations.

The Association remained under written Supervisory Agreement as of the date of this report.

#### **Note 10 — Subsequent Events**

The Association has evaluated subsequent events and has determined there are none requiring disclosure through May 9, 2014, which is the date the financial statements were issued.