

# **LONE STAR, ACA**

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## **2011 Quarterly Report Third Quarter**



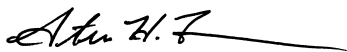
**For the Quarter Ended September 30, 2011**

## REPORT OF MANAGEMENT

To meet its responsibility for reliable financial information, management depends on the Farm Credit Bank of Texas' and the Lone Star Ag Credit association's accounting and internal control systems, which have been designed to provide reasonable, but not absolute, assurance that assets are safeguarded and transactions are properly authorized and recorded. The systems have been designed to recognize that the cost of controls must be related to the benefits derived. The annual consolidated financial statements are audited by PricewaterhouseCoopers LLP, independent accountants, who conduct a review of internal controls solely for the purpose of establishing a basis for reliance thereon in determining the nature, extent and timing of audit tests applied in the audit of the consolidated financial statements in accordance with auditing standards generally accepted in the United States of America. The association is also examined by the Farm Credit Administration.

The board of directors has overall responsibility for the association's systems of internal control and financial reporting. The board consults regularly with management and reviews the results of the audits and examinations referred to previously.

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.



Steve Fowlkes, Chief Executive Officer

*November 7, 2011*



Bruce Duncan, Chairman, Board of Directors

*November 7, 2011*



M'Lissa Kiel, Chief Financial Officer

*November 7, 2011*



Don Crawford, Chairman of the Audit Committee

*November 7, 2011*

## **LONE STAR, ACA MANAGEMENT'S DISCUSSION AND ANALYSIS**

The following commentary reviews the financial performance of the Lone Star, 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:**

As discussed in the 2010 annual report the association underwent an examination by the Farm Credit Administration (FCA) during the third quarter of 2009. The examination report, dated December 22, 2009, cited a severe management and internal control weakness in credit operations and credit administration. As a result of the examination the association identified and recorded additional credit downgrades and a corresponding increase in the allowance for loan losses, which were reflected in the financial results for December 31, 2009. Throughout 2010, the association continued to identify and record additional credit downgrades and corresponding increase in the allowance for loan losses, which were reflected in the financial results for 2010, and continued to work to remediate the material weaknesses in internal control over financial reporting which were cited in FCA's report. Management's review through the second quarter of 2011 revealed that there were no new material weaknesses. Additionally, existing internal controls were enhanced through training of management and staff, and the addition of key staff members. On May 1, 2010, Steve Fowlkes, interim CEO was named permanent CEO and Troy Bussmeir was named CCO. Steve Fowlkes previously served as CCO for the Farm Credit Bank of Texas, and Troy Bussmeir previously served as Relationship Manager for the Farm Credit Bank of Texas (bank).

The association has a contractual lending relationship with the Farm Credit Bank of Texas from which the association borrows to fund the majority of its loan portfolio. The indebtedness is collateralized by a pledge of substantially all of the association's assets, and is governed by a general financing agreement (agreement) which contains certain loan covenants. The association received a "Notice of Default and Limited Waiver of Certain Requirements in the GFA" from the bank on January 21, 2010, March 5, 2010, April 28, 2010, September 2, 2010, January 31, 2011 and March 3, 2011. The current waiver expires February 29, 2012. The notices stated that the association was in default under the agreement. The bank has granted limited waivers of these defaults provided that the association complies with all of the actions outlined in its response to the December 2009 FCA report.

### **Loan Portfolio:**

Total loans outstanding at September 30, 2011, including nonaccrual loans and sales contracts, were \$876,496,019 compared to \$958,022,787 at December 31, 2010, reflecting a decrease of 8.5 percent. Nonaccrual loans as a percentage of total loans outstanding were 10.0 percent at September 30, 2011, compared to 9.5 percent at December 31, 2010.

The association recorded \$2,856 in recoveries and \$2,248,564 in charge-offs for the quarter ending September 30, 2011, and \$124,037 in recoveries and \$294,252 in charge-offs for the same period in 2010. The association's allowance for loan losses was 2.1 percent and 2.0 percent of total loans outstanding as of September 30, 2011, and December 31, 2010, respectively.

### **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	\$ 87,298,269	94.7%	\$ 90,870,374	90.6%
90 days past due and still accruing interest	1,634	0.0%	-	0.0%
Formally restructured	-	0.0%	-	0.0%
Other property owned, net	4,860,272	5.3%	9,471,968	9.4%
Total	\$ 92,160,174	100.0%	\$ 100,342,342	100.0%

The association experienced a \$3,600,179 net decrease in nonaccrual volume for the first nine months of 2011.

#### Investments:

During the first quarter of 2010, the association exchanged \$59,626,146 of mortgage loans that previously were covered under a Long-Term Standby Commitment to Purchase Agreement with Federal Agricultural Mortgage Corporation (Farmer Mac) for a Farmer Mac guaranteed agricultural mortgage-backed security. No gain or loss was recognized in the financial statements upon completion of the exchange transaction. The association continues to service the loans included in this transaction. These investments in guaranteed securities are included in this report's Consolidated Balance Sheet as investments – held-to-maturity.

#### Results of Operations:

	Quarter Ended September 30,		Change	Nine Months Ended September 30,		Change
	2011	2010		2011	2010	
INTEREST INCOME						
Total interest income	\$ 11,768,131	\$ 13,243,080	-11.1%	\$ 36,448,156	\$ 41,763,487	-12.7%
Total interest expense	4,961,442	6,514,483	-23.8%	16,046,666	20,068,707	-20.0%
Net interest income	6,806,690	6,728,597	1.2%	20,401,490	21,694,780	-6.0%
PROVISIONS FOR LOSSES						
Provision for loan losses	1,812,245	2,271,612	-20.2%	4,711,318	16,860,751	-72.1%
Provision for acquired property losses	1,265,590	587,731	115.3%	3,752,591	2,787,241	34.6%
NET INCOME (LOSS)	\$ 1,700,867	\$ 1,734,820	-2.0%	\$ 5,616,863	\$ (2,457,038)	328.6%

The increase in net income for the nine months ended September 30, 2011 is a result of the decrease in provision for loan losses, partially offset by the decrease in net interest income, due primarily to a decline in average volume outstanding for the same period, as reflected in the chart below.

	Nine Months Ended June 30,		Increase/ (Decrease)
	2011	2010	
Average Loan Volume	\$ 925,964,351	\$ 1,038,140,530	-10.8%
Average Loan Portfolio Spread	2.47	2.14	15.4%
ROA	0.76%	-0.30%	353.3%
ROE	4.35%	-1.92%	326.6%
Allowance for loan losses to total loans	2.09%	1.93%	8.3%

#### Liquidity and Funding Sources:

The association secures the majority of its lendable funds from the Farm Credit Bank of Texas (the bank), which obtains its funds through the issuance of Systemwide obligations and with lendable equity. The following schedule summarizes the association's borrowings.

	<b>September 30, 2011</b>	<b>December 31, 2010</b>
Note payable to the bank	\$ <b>751,302,203</b>	\$ 850,095,961
Accrued interest on note payable	<b>1,568,156</b>	2,016,598
Total	<b>\$ 752,870,359</b>	<b>\$ 852,112,559</b>

The decrease in the note payable to the FCBT, of \$99,242,200 for the first nine months of 2011 is attributable to the decrease in the association's loan volume. The note payable to the FCBT carried a weighted average interest rate of 2.50 percent as of September 30, 2011, compared to 2.74 percent as of December 31, 2010. The indebtedness is collateralized by a pledge of substantially all of the association's assets to the FCBT and governed by a financing agreement.

The liquidity policy of the association is to manage cash balances to maximize debt reduction. This policy will continue to be pursued during 2011. As borrower's payments are received, they are applied to the association's direct note payable with the FCBT.

The association will continue to fund its operations through direct borrowings from the FCBT, capital surplus from prior years, and borrower stock. It is management's opinion that funds available to the association are sufficient to fund its operations for the current year.

### **Capital Resources:**

The association's capital position of \$173,961,408 at September 30, 2011 increased by \$5,137,141, compared to \$168,824,267 at December 31, 2010. The association's debt as a percentage of members' equity was 4.36:1 as of September 30, 2011, compared to 5.07:1 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 17.0 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 16.5 and 16.5 percent, respectively, which is in compliance with the FCA's minimum surplus standard.

### **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 Financial Accounting Standards Board (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 Lone Star, 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 Lone Star, ACA, 1612 Summit Avenue, Suite 300, Fort Worth, TX, 76102 or calling (817)332-6565. Copies of the association's quarterly stockholder reports can also be requested by e-mailing [Lydia.Laske@lonestaragcredit.com](mailto:Lydia.Laske@lonestaragcredit.com).

**LONE STAR, ACA**  
**CONSOLIDATED BALANCE SHEET**

	<b>September 30, 2011 (unaudited)</b>	<b>December 31, 2010</b>
<b><u>ASSETS</u></b>		
Cash	\$ 69,111	\$ 66,243
Investments	37,051,443	45,231,568
Loans	876,496,019	958,022,787
Less: allowance for loan losses	18,454,372	19,067,611
Net loans	858,041,647	938,955,176
Accrued interest receivable	8,587,953	7,748,626
Investment in and receivable from the bank:		
Capital stock	18,570,550	18,570,550
Other	2,148,072	1,856,461
Other property owned, net	4,860,272	9,471,968
Premises and equipment	1,715,679	1,532,386
Other assets	945,687	797,994
Total assets	\$ 931,990,414	\$ 1,024,230,972
<b><u>LIABILITIES</u></b>		
Note payable to the bank	\$ 751,302,203	\$ 850,095,961
Accrued interest payable	1,568,157	2,016,598
Drafts outstanding	137,998	23,786
Other liabilities	5,020,648	3,270,360
Total liabilities	758,029,006	855,406,705
<b><u>MEMBERS' EQUITY</u></b>		
Capital stock and participation certificates	4,136,725	4,417,400
Unallocated retained earnings	170,289,128	164,672,264
Accumulated other comprehensive income (loss)	(464,445)	(265,397)
Total members' equity	173,961,408	168,824,267
Total liabilities and members' equity	\$ 931,990,414	\$ 1,024,230,972

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

LONE STAR, 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	\$ 11,301,658	\$ 12,466,771	\$ 34,773,723	\$ 40,152,025
Investments	466,473	776,309	1,674,433	1,611,462
Total interest income	11,768,131	13,243,080	36,448,156	41,763,487
<b><u>INTEREST EXPENSE</u></b>				
Note payable to the bank	4,961,428	6,514,460	16,046,647	20,068,590
Advance conditional payments	14	23	19	117
Total interest expense	4,961,442	6,514,483	16,046,666	20,068,707
Net interest income	6,806,690	6,728,597	20,401,490	21,694,780
<b><u>PROVISION FOR LOAN LOSSES</u></b>				
	1,812,245	2,271,612	4,711,318	16,860,751
Net interest income after provision for loan losses	4,994,445	4,456,985	15,690,172	4,834,029
<b><u>NONINTEREST INCOME</u></b>				
Income from the bank:				
Patronage income	402,965	476,803	1,260,537	1,482,802
Loan fees	110,993	515,233	390,225	1,602,205
Financially related services income	24,917	22,871	46,818	76,975
Gain (loss) on other property owned, net	207,420	(73,910)	437,141	(69,249)
Gain (loss) on sale of premises and equipment, net	122,000	825	122,400	925
Other noninterest income	482	755	64,388	1,192,534
Net impairment loss recognized in earnings	868,295	941,822	2,257,121	3,093,658
Total noninterest income	868,777	942,577	2,321,509	4,286,192
<b><u>NONINTEREST EXPENSES</u></b>				
Salaries and employee benefits	1,715,171	1,698,646	5,013,313	4,492,467
Directors' expense	27,018	63,194	232,457	276,912
Purchased services	250,468	316,856	702,695	1,160,340
Travel	158,265	128,193	393,332	335,134
Occupancy and equipment	180,457	191,449	518,033	580,826
Communications	47,919	49,644	133,800	143,544
Advertising	57,448	120,864	128,394	239,041
Public and member relations	106,459	103,306	347,287	333,184
Supervisory and exam expense	100,374	108,279	316,931	286,703
Insurance Fund premiums	135,522	130,811	419,919	389,567
Other noninterest expense	1,400,023	753,500	4,198,830	3,339,541
Total noninterest expenses	4,179,124	3,664,742	12,404,991	11,577,259
Income before income taxes	1,684,098	1,734,820	5,606,690	(2,457,038)
Provision for (benefit from) income taxes	(16,769)	-	(10,173)	-
Net income	\$ 1,700,867	\$ 1,734,820	\$ 5,616,863	\$ (2,457,038)

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

LONE STAR, ACA

CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY

(unaudited)

	Capital Stock/ Participation Certificates	Additional Paid-in-Capital	Retained Earnings		Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
			Allocated	Unallocated		
Balance at December 31, 2009	\$ 4,726,260	\$ -	\$ -	\$ 168,176,219	\$ 7,376	\$ 172,909,855
Comprehensive income						
Net income	-	-	-	(2,457,037)	-	(2,457,037)
Change in postretirement benefit plans	-	-	-	-	(69,599)	(69,599)
Total comprehensive income	-	-	-	(2,457,037)	(69,599)	(2,526,636)
Capital stock/participation certificates and allocated retained earnings issued	269,265	-	-	-	-	269,265
Capital stock/participation certificates and allocated retained earnings retired	(501,290)	-	-	-	-	(501,290)
Cash	-	-	-	(2,347,350)	-	(2,347,350)
<b>Balance at September 30, 2010</b>	<b>\$ 4,494,235</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 163,371,832</b>	<b>\$ (62,223)</b>	<b>\$ 167,803,844</b>
Balance at December 31, 2010	\$ 4,417,400	\$ -	\$ -	\$ 164,672,264	\$ (265,397)	\$ 168,824,267
Comprehensive income						
Net income	-	-	-	5,616,864	-	5,616,864
Change in postretirement benefit plans	-	-	-	-	(199,048)	(199,048)
Total comprehensive income	-	-	-	5,616,864	(199,048)	5,417,816
Capital stock/participation certificates and allocated retained earnings issued	445,990	-	-	-	-	445,990
Capital stock/participation certificates and allocated retained earnings retired	(726,665)	-	-	-	-	(726,665)
<b>Balance at September 30, 2011</b>	<b>\$ 4,136,725</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 170,289,128</b>	<b>\$ (464,445)</b>	<b>\$ 173,961,408</b>

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

**LONE STAR, ACA**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(UNAUDITED)

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

The Lone Star, 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 Hood, Johnson, Somervell, Tarrant, Denton, Wise, Dallas, Bowie, Camp, Cass, Morris, Titus, Delta, Lamar, Red River, Cooke, Fannin, Grayson, Eastland, Erath, Palo Pinto, Parker, Shackelford, Stephens, Throckmorton, Young, Borden, Fisher, Kent, Mitchell, Nolan, Scurry and Taylor 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 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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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).
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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 — INVESTMENTS:

### Mission-Related and Other Investments Held-to-Maturity

A summary of the amortized cost and fair value of mission-related and other investment securities held-to-maturity is as follows:

<u>September 30, 2011</u>	Gross		Gross		Weighted Average Yield
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value	
Mortgage-backed securities	\$ 37,051,443	\$ 727,818	-	\$ 37,779,261	5.41 %
Asset-backed securities	-	-	-	-	-
Total	<u>\$ 37,051,443</u>	<u>\$ 727,818</u>	<u>-</u>	<u>\$ 37,779,261</u>	<u>5.41 %</u>

<u>December 31, 2010</u>	Gross		Gross		Weighted Average Yield
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value	
Mortgage-backed securities	\$ 45,231,568	\$ 284,022	-	\$ 45,515,590	5.42 %
Asset-backed securities	-	-	-	-	-
Total	<u>\$ 45,231,568</u>	<u>\$ 284,022</u>	<u>-</u>	<u>\$ 45,515,590</u>	<u>5.42 %</u>

During the first quarter of 2010, \$59,626 million of agricultural mortgage loans previously covered under a Long-Term Standby Commitment to Purchase agreement with the Federal Agricultural Mortgage Corporation (Farmer Mac) were securitized. No gain or loss was recognized in the financial statements upon completion of the securitization. Terms of the agreement call for a guarantee fee of 20-50 basis points to be paid to Farmer Mac, and for the association to receive a 30-basis-point fee for servicing the underlying loans.

The following is a summary of Farmer Mac agricultural mortgage-backed securities:

	<u>September 30, 2011</u>				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Agricultural mortgage-backed securities	\$ 37,051,443	\$ 727,818	\$ -	\$ 37,779,261	5.41 %

	<u>December 31, 2010</u>				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Weighted Average Yield
Agricultural mortgage-backed securities	\$ 45,231,568	\$ 284,022	\$ -	\$ 45,515,590	5 %

The association evaluates investment securities for other-than-temporary impairment on a quarterly basis. Impairment is considered to be other than temporary if an entity (i) intends to sell the security, (ii) is more likely than not to be required to sell the security before recovering its cost, or (iii) does not expect to recover the security's entire amortized cost basis (even if the entity does not intend 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, other-than-temporary impairment is considered using various factors, including the length of time and the extent to which the fair value is less than cost, adverse conditions specifically related to the industry, geographic area and the condition of the underlying collateral, payment structure of the security, ratings by rating agencies, the creditworthiness of

bond insurers and volatility of the fair value changes. The association uses estimated cash flows over the remaining lives of the underlying collateral to assess whether credit losses exist. In estimating cash flows, it considers factors such as expectations of relevant market and economic data, including underlying loan level data for mortgage-backed and asset-backed securities and credit enhancements.

### NOTE 3 — 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	\$ 701,963,911	\$ 760,724,047
Production and intermediate term	105,396,366	139,139,214
Agribusiness:		
Loans to cooperatives	179,058	2,988,302
Processing and marketing	37,328,132	30,430,889
Farm-related business	3,439,211	4,509,956
Communication	5,584,413	1,699,955
Energy	5,556,271	753,480
Water and waste disposal	1,288,113	-
Rural residential real estate	15,760,546	17,776,944
Total	<b>\$ 876,496,019</b>	<b>\$ 958,022,787</b>

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	\$9,346,596.37	\$13,868,042.29	\$-	\$-	\$9,346,596.37	\$13,868,042.29
Production and intermediate term	13,723,592.61	-	-	198,244.58	13,723,593	198,245
Agribusiness Loans to Co-ops	179,057.60	-	-	-	179,058	-
Agribusiness Processing and Marketing	30,525,592.41	2,524,628.62	-	-	30,525,592	2,524,629
Communication	5,584,412.50	-	-	-	5,584,413	-
Energy	5,556,270.62	-	-	-	5,556,271	-
Water and waste disposal	1,288,112.67	-	-	-	1,288,113	-
Total	<b>\$66,203,634.78</b>	<b>\$16,392,670.91</b>	<b>\$-</b>	<b>\$198,244.58</b>	<b>\$66,203,634.78</b>	<b>\$16,590,915.49</b>

Nonperforming 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	\$ 47,795,163	\$ 49,122,714
Production and intermediate term	32,103,285	32,030,878
Agribusiness Farm-related business	1,161,355	1,491,924
Agribusiness Processing and Marketing	5,910,001	7,800,597
Rural residential real estate	328,465	424,261
Total nonaccrual loans	<u>87,298,269</u>	<u>90,870,374</u>
<b>Accruing restructured loans:</b>		
Real estate mortgage	1,634	-
Total accruing restructured loans	<u>1,634</u>	<u>-</u>
Total nonperforming loans	87,299,902	90,870,374
Other property owned	4,860,272	9,471,968
Total nonperforming assets	<u>\$ 92,160,174</u>	<u>\$ 100,342,342</u>

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	87.0 %	85.5 %
OAEM	2.5	2.8
Substandard/doubtful	10.5	11.7
	<u>100.0</u>	<u>100.0</u>
Production and intermediate term		
Acceptable	53.7	50.4
OAEM	5.7	10.1
Substandard/doubtful	40.5	39.5
	<u>100.0</u>	<u>100.0</u>
Agribusiness Farm-related business		
Acceptable	58.2	62.7
OAEM	3.7	-
Substandard/doubtful	38.1	37.3
	<u>100.0</u>	<u>100.0</u>
Agribusiness Processing and Marketing		
Acceptable	79.9	66.0
OAEM	4.2	8.3
Substandard/doubtful	15.8	25.6
	<u>100.0</u>	<u>100.0</u>
Agribusiness Loans to Cooperatives		
Acceptable	100.0	100.0
OAEM	-	-
Substandard/doubtful	-	-
	<u>100.0</u>	<u>100.0</u>
Energy and water/waste disposal		
Acceptable	100.0	100.0
OAEM	-	-
Substandard/doubtful	-	-
	<u>100.0</u>	<u>100.0</u>
Communication		
Acceptable	100.0	100.0
OAEM	-	-
Substandard/doubtful	-	-
	<u>100.0</u>	<u>100.0</u>
Rural residential real estate		
Acceptable	87.9	89.7
OAEM	2.2	6.4
Substandard/doubtful	9.9	3.9
	<u>100.0</u>	<u>100.0</u>
Lease receivables		
Acceptable	-	100.0
OAEM	-	-
Substandard/doubtful	-	-
	<u>-</u>	<u>100.0</u>
Total Loans		
Acceptable	82.8	79.9
OAEM	3.0	4.0
Substandard/doubtful	14.3	16.1
	<u>100.0 %</u>	<u>100.0 %</u>

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	\$ 4,690,577	\$ 15,133,589	\$ 19,824,166	\$ 682,139,744	\$ 701,963,911	\$ -
Production and intermediate term	1,052,128	12,814,561	13,866,690	91,529,676	105,396,366	-
Loans to cooperatives	-	-	-	179,058	179,058	-
Processing and marketing	-	5,406,547	5,406,547	31,921,585	37,328,131	-
Farm-related business	-	-	-	3,439,211	3,439,211	-
Communication	-	-	-	5,584,413	5,584,413	-
Energy and water/waste disposal	-	-	-	6,844,383	6,844,383	-
Rural residential real estate	180,445	35,581	216,027	15,544,520	15,760,546	-
Total	\$ 5,923,150	\$ 33,390,279	\$ 39,313,429	\$ 837,182,590	\$ 876,496,019	\$ -

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 Investment	Unpaid Principal Balance <sup>a</sup>	Related Allowance	Average Impaired Loans	Interest Income Recognized	Average Impaired Loans	Interest Income Recognized
Impaired loans with a related allowance for credit losses:							
Real estate mortgage	\$ 4,885,644	\$ 5,085,737	\$ 1,076,174	\$ 5,361,363	\$ -	\$ 10,353,075	\$ 2,920
Production and intermediate term	15,726,153	18,010,815	14,003,722	12,877,038	1,565	16,506,311	4,888
Processing and marketing	603,627	603,627	282,643	1,788,925	-	2,099,064	(1,277)
Farm-related business	1,161,355	1,441,204	215,052	1,167,156	29,279	1,185,231	66,510
Rural residential real estate	220,843	220,843	25,783	223,233	-	244,223	-
Total	\$ 22,597,623	\$ 25,362,226	\$ 15,603,373	\$ 21,417,715	\$ 30,844	\$ 30,387,904	\$ 73,040
Impaired loans with no related allowance for credit losses:							
Real estate mortgage	\$ 42,911,153	\$ 43,621,415	\$ -	\$ 43,166,901	\$ 78,754	\$ 43,485,224	\$ 347,111
Production and intermediate term	16,377,132	23,380,496	-	21,353,081	92,924	18,951,822	149,020
Processing and marketing	5,306,373	5,306,373	-	5,673,942	-	5,564,142	(303)
Farm-related business	-	-	-	-	2,201	-	6,576
Rural residential real estate	107,622	107,622	-	108,133	221	86,776	722
Total	\$ 64,702,280	\$ 72,415,907	\$ -	\$ 70,302,057	\$ 174,101	\$ 68,087,964	\$ 503,128
Total impaired loans:							
Real estate mortgage	\$ 47,796,797	\$ 48,707,152	\$ 1,076,174	\$ 48,528,264	\$ 78,754	\$ 53,838,299	\$ 350,031
Production and intermediate term	32,103,285	41,391,311	14,003,722	34,230,119	94,489	35,458,133	153,908
Processing and marketing	5,910,001	5,910,001	282,643	7,462,867	-	7,663,206	(1,580)
Farm-related business	1,161,355	1,441,204	215,052	1,167,156	31,480	1,185,231	73,087
Rural residential real estate	328,465	328,465	25,783	331,366	221	330,999	722
Total	\$ 87,299,902	\$ 97,778,133	\$ 15,603,373	\$ 91,719,772	\$ 204,945	\$ 98,475,868	\$ 576,168

	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	\$ 9,087,846	\$ 9,296,986	\$ 1,649,989	\$ -	\$ -
Production and intermediate term	16,869,987	21,543,168	13,723,795	-	-
Processing and marketing	2,459,062	2,458,973	531,891	-	-
Farm-related business	1,491,924	1,500,362	610,836	-	-
Rural residential real estate	306,634	350,644	78,657	-	-
Total	\$ 30,215,453	\$ 35,150,133	\$ 16,595,168	\$ -	\$ -
Impaired loans with no related allowance for credit losses:					
Real estate mortgage	\$ 40,034,867	\$ 41,268,632	\$ -	\$ -	\$ -
Production and intermediate term	15,160,891	21,059,912	-	-	-
Processing and marketing	5,341,535	8,563,641	-	-	-
Farm-related business	-	105,924	-	-	-
Rural residential real estate	117,627	145,196	-	-	-
Total	\$ 60,654,920	\$ 71,143,305	\$ -	\$ -	\$ -
Total impaired loans:					
Real estate mortgage	\$ 49,122,713.00	\$ 50,565,618.00	\$ 1,649,989.00	\$ -	\$ -
Production and intermediate term	32,030,878	42,603,080	13,723,795	-	-
Processing and marketing	7,800,597	11,022,614	531,891	-	-
Farm-related business	1,491,924	1,606,286	610,836	-	-
Rural residential real estate	424,261	495,840	78,657	-	-
Total	\$ 90,870,373	\$ 106,293,438	\$ 16,595,168	\$ 76,790,870	\$ 1,441,004

<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	Total
<b>Allowance for Credit Losses:</b>							
Balance at							
December 31, 2010	\$ 3,528,497	\$ 14,203,340	\$ 1,232,781	\$ 2,716	\$ 1,204	\$ 99,070	\$ 19,067,608
Charge-offs	(1,225,564)	(2,206,119)	(1,941,802)	-	-	(17,220)	(5,390,705)
Recoveries	-	48,928	-	-	-	17,220	66,148
Provision for loan losses	213,274	3,161,888	1,276,172	1,464	3,560	54,964	4,711,322
Balance at							
September 30, 2011	\$ 2,516,207	\$ 15,208,037	\$ 567,151	\$ 4,180	\$ 4,764	\$ 154,034	\$ 18,454,373
Ending Balance:							
individually evaluated for impairment	\$ 1,076,174	\$ 14,282,407	\$ 497,694	\$ -	\$ -	\$ 25,784	\$ 15,882,059
Ending Balance:							
collectively evaluated for impairment	\$ 1,440,034	\$ 925,630	\$ 69,456	\$ 4,180	\$ 4,764	\$ 128,250	\$ 2,572,314
<b>Recorded Investments in Loans Outstanding:</b>							
Ending Balance at							
September 30, 2011	\$ 709,767,460	\$ 106,010,673	\$ 41,034,715	\$ 5,596,898	\$ 6,845,905	\$ 15,828,321	\$ 885,083,972
Ending Balance for loans individually evaluated for impairment	\$ 47,795,164	\$ 32,103,285	\$ 7,071,356	\$ -	\$ -	\$ 328,465	\$ 87,298,270
Ending Balance for loans collectively evaluated for impairment	\$ 661,972,296	\$ 73,907,387	\$ 33,693,359	\$ 5,596,898	\$ 6,845,905	\$ 15,499,855	\$ 797,515,700

#### NOTE 4 — 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 5 — INCOME TAXES:

Lone Star, 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, and 2010 net income for tax purposes the association carries a deferred tax asset of \$14,173,506 and \$11,569,209 respectively with full valuation allowance recorded against the asset each year.

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

**NOTE 6 — 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 12 to the 2010 Annual Report to Stockholders for a more complete description.

Assets and liabilities measured at fair value on a recurring basis 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:				
Assets held in nonqualified benefit trusts	<u>\$ 24,118</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 24,118</u>
Total assets	<u>24,118</u>	<u>-</u>	<u>-</u>	<u>24,118</u>
Liabilities:				
Standby letters of credit	<u>-</u>	<u>3,680,384</u>	<u>-</u>	<u>3,680,384</u>
Total liabilities	<u>\$ -</u>	<u>\$ 3,680,384</u>	<u>\$ -</u>	<u>\$ 3,680,384</u>

<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:				
Assets held in nonqualified benefit trusts	<u>\$ 51,280</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 51,280</u>
Total assets	<u>51,280</u>	<u>-</u>	<u>-</u>	<u>51,280</u>
Liabilities:				
Standby letters of credit	<u>-</u>	<u>3,429,454</u>	<u>-</u>	<u>3,429,454</u>
Total liabilities	<u>\$ -</u>	<u>\$ 3,429,454</u>	<u>\$ -</u>	<u>\$ 3,429,454</u>

The table below presents significant transfers in and out of Level 1 during the months ended September 30, 2011 for all assets measured at fair value on a recurring basis:

	<u>Total Fair Value Measurement</u>	
	<u>Level 1 Assets</u>	
	<u>Investments Available for Sale</u>	<u>Assets Held in Nonqualified Benefits Trusts</u>
Transfers into Level 1	\$ -	\$ -
Transfers out of Level 1	-	(24,661.00)

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 *	\$ -	\$ -	\$ 48,123,628	\$ 48,123,628
Other property owned	-	-	4,860,272	4,860,272
<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 *	\$ -	\$ -	\$ 74,759,366	\$ 74,759,366
Other property owned	-	-	9,471,968	9,471,968

\*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 12 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.

#### *Investment Securities*

Where quoted prices are available in an active market, available-for-sale securities are classified as Level 1. If quoted prices are not available in an active market, the fair value of securities is estimated using quoted prices for similar securities received from pricing services, pricing models that utilize observable inputs or discounted cash flows. Where there is limited activity or less transparency around inputs to the valuation, the securities are classified as Level 3. Securities classified within Level 3 include asset-backed securities and certain mortgage-backed securities, including those issued by Farmer Mac.

#### *Assets Held in Nonqualified Benefits Trusts*

Assets held in trust funds related to deferred compensation and supplemental retirement plans are classified within Level 1. The trust funds include investments that are actively traded and have quoted net asset values that are observable in the marketplace.

#### *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 7 — 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	\$ 47,571	\$ 30,188
Interest cost	89,345	54,358
Amortization of prior service costs	(103,763)	(70,820)
Amortizations of net (gain) loss	46,917	24,420
Net periodic benefit cost	<u>\$ 80,070</u>	<u>\$ 38,146</u>

The structure of the district's defined benefit pension plan is characterized as multi-employer since the assets, liabilities and cost of the plan are not segregated or separately accounted for by participating employers (bank and associations). The association recognizes its amortized annual contributions to the plan as an expense. The association previously disclosed in its financial statements for the year ended December 31, 2010, that it expected to contribute \$890,942 to the district's defined benefit pension plan in 2011. As of September 30, 2011, \$668,206 of contributions have been made. The association presently anticipates contributing an additional \$222,736 to fund the defined benefit pension plan in 2011 for a total of \$890,942.

**NOTE 8 — 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 9 — SUBSEQUENT EVENTS:**

The association has evaluated subsequent events through November 7, 2011, which is the date the financial statements were issued.