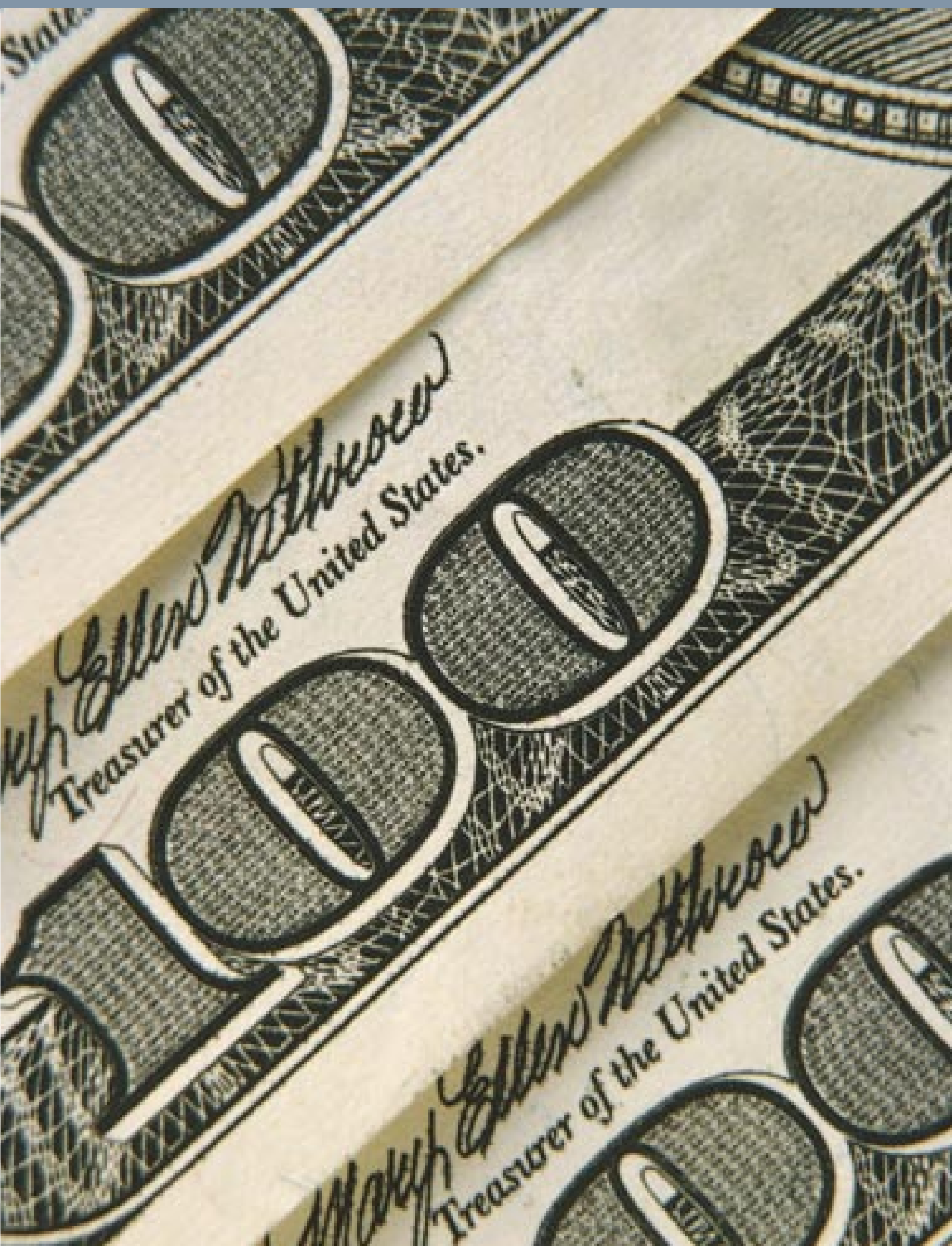
First South
Farm Credit

ANNUAL REPORT 2004



FIRST SOUTH FARM CREDIT, ACA

2004 ANNUAL REPORT

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Stephen L. Rochelle....President & Chief Executive Officer
Bryan Applewhite....Chief Financial Officer/Senior Vice President/Treasurer
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Randy Underwood....Senior Vice President/Chief Credit Officer
Roger Chappell....President, North Alabama Division
Cecil Corbello....President, Louisiana Division
John Barnard....President, Mississippi Division
Camp Powers....President, South Alabama Division

Board of Directors

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William H. Voss....Vice Chairman
Larry Arnaud....Director
Billy Ross Brown....Director
John R. Burden....Director
Dr. Marty J. Fuller....Director
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Thomas H. Nelson, Jr.....Director
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Thomas A. Parker....Director
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Robert E. Potts....Director
Walter R. Richardson....Director
D. Derwood Strain....Director
Mike Unkel....Director
Dan West....Director

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Message from the Chief Executive Officer

First South Farm Credit, ACA continues to add value to the agricultural economy of Alabama, Louisiana, Mississippi and rural America by posting another successful year for the Association and its member/stockholders.

First South achieved record earnings in 2004 and now has assets approaching $1 billion.

For the 10th consecutive year, the Board of Directors voted to approve a patronage distribution of Association earnings.

First South is proud to announce that it has now distributed **over $100 million** in cash and allocated patronage distributions to its member/stockholders since the inception of the patronage program. This is an important measurement of our company's success and commitment to its members.

This is important to you as a borrower because you get a competitive interest rate up front, plus a measurable patronage dividend that has been ongoing for 10 years. Our history of patronage distributions is proof of our commitment to operate as a true cooperative.

First South is the premier Farm Credit lending association in Alabama, Louisiana and Mississippi, and has operated successfully since 1933. We are committed to supplying reliable credit and lending services to the agricultural communities in Alabama, Louisiana and Mississippi as well as rural America.

It is the philosophy of First South that borrowers and potential borrowers should have a choice of institutions when it comes to borrowing money. Our structure allows us to take advantage of Farm Credit laws and regulations that enhance our ability to offer a broad range of loan products, competitive interest rates and credit services to help make rural America a more productive place to live and raise a family.

First South wants to be sure that when it comes to financing, whether it is for land, production or agribusiness purposes, you have a choice. We are committed to being the lender of choice in Alabama, Louisiana and Mississippi.

Stephen L. Rochelle
Chief Executive Officer

March 4, 2005

Report of Management

The accompanying consolidated financial statements and related financial information appearing throughout this annual report have been prepared by management of First South Farm Credit, ACA (the Association) in accordance with generally accepted accounting principles appropriate in the circumstances. Amounts which must be based on estimates represent the best estimates and judgments of management. Management is responsible for the integrity, objectivity, consistency, and fair presentation of the consolidated financial statements and financial information contained in this report.

Management maintains and depends upon an internal accounting control system designed to provide reasonable assurance that transactions are properly authorized and recorded, that the financial records are reliable as the basis for the preparation of all financial statements, and that the assets of the Association are safeguarded. The design and implementation of all systems of internal control are based on judgments required to evaluate the costs of controls in relation to the expected benefits and to determine the appropriate balance between these costs and benefits. The Association maintains an internal audit program to monitor compliance with the systems of internal accounting control. Audits of the accounting records, accounting systems and internal controls are performed and internal audit reports including appropriate recommendations for improvement, are submitted to the Board of Directors.

The consolidated financial statements have been examined by independent public auditors, whose report appears elsewhere in this annual report. The Association is also subject to examination by the Farm Credit Administration.

The consolidated financial statements, in the opinion of management, fairly present the financial condition of the Association. The undersigned certify that the 2004 Annual Report 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 our knowledge and belief.

Paul Clark
Chairman of the Board

Stephen L. Rochelle
Chief Executive Officer

Bryan Applewhite
Chief Financial Officer

March 4, 2005

Consolidated Five - Year Summary of Selected Financial Data

(UNAUDITED)

(dollars in thousands)	2004	2003	December 31, 2002	2001	2000
Balance Sheet Data					
Cash	$ 10,375	$ 10,372	$ 11,455	$ 12,164	$ 15,534
Loans	889,076	839,911	844,501	708,973	605,849
Less: allowance for loan losses	5,189	20,630	20,717	19,628	17,554
Net loans	883,887	819,281	823,784	689,345	588,295
Investment in other Farm Credit institutions	61,513	62,314	63,705	64,934	64,934
Other property owned	739	434	56	45	327
Other assets	29,042	26,438	28,148	26,572	26,347
Total assets	$ 985,556	$ 918,839	$ 927,148	$ 793,060	$ 695,437
Notes payable to AgFirst Farm Credit Bank*	$ 759,497	$ 712,060	$ 724,781	$ 594,241	$ 498,953
Accrued interest payable and other liabilities with maturities of less than one year	23,396	24,794	25,394	25,392	24,837
Total liabilities	782,893	736,854	750,175	619,633	523,790
Protected borrower equity	142	147	147	175	213
Capital stock and participation certificates	63,360	62,952	62,260	61,448	60,723
Retained earnings					
Allocated	58,064	52,081	46,056	41,390	39,263
Unallocated	81,097	66,805	68,510	70,414	71,448
Total members' equity	202,663	181,985	176,973	173,427	171,647
Total liabilities and members' equity	$ 985,556	$ 918,839	$ 927,148	$ 793,060	$ 695,437
Statement of Income Data					
Net interest income	$ 25,975	$ 25,885	$ 23,839	$ 22,131	$ 22,073
Provision for (reversal of) loan losses	(14,809)	1,200	1,200	1,960	1,110
Noninterest income (expense), net	(10,478)	(11,944)	(9,506)	(8,690)	(9,076)
Net income	$ 30,306	$ 12,741	$ 13,133	$ 11,481	$ 11,887
Key Financial Ratios					
Rate of return on average:					
Total assets	3.20%	1.36%	1.58%	1.52%	1.81%
Total members' equity	16.52%	7.09%	7.92%	6.70%	6.99%
Net interest income as a percentage of average earning assets	2.98%	3.00%	2.98%	3.27%	3.80%
Net chargeoffs (recoveries) to average loans	0.072%	0.148%	0.01%	(0.02)%	0.001%
Total members' equity to total assets	20.56%	19.81%	19.09%	21.87%	24.68%
Debt to members' equity (:1)	3.86	4.05	4.24	3.57	3.05
Allowance for loan losses to loans	0.58%	2.46%	2.45%	2.77%	2.90%
Permanent capital ratio	13.59%	13.84%	13.51%	14.05%	16.82%
Total surplus ratio	12.21%	12.46%	12.17%	13.52%	15.19%
Core surplus ratio	9.38%	9.40%	9.16%	12.59%	14.07%
Net Income Distribution					
Estimated patronage refunds:					
Cash dividend	$ 3,101	$ 2,800	$ 3,727	$ 3,685	$ 4,718
Qualified allocated surplus	4,652	4,199	5,591	8,598	7,077
Nonqualified allocated surplus	3,845	3,069	2,244	—	—
Nonqualified retained surplus	4,651	4,466	3,485	—	—

* *General financing agreement is renewable on three-year cycles. The next renewal date is December 31, 2007.*

Management's Discussion & Analysis of Financial Condition & Results of Operations

(dollars in thousands, except as noted)

GENERAL OVERVIEW

The following commentary summarizes the financial condition and results of operations of First South Farm Credit, ACA, (the Association) for the year ended December 31, 2004 with comparisons to the year ended December 31, 2003. This information should be read in conjunction with the Consolidated Financial Statements, Notes to the Consolidated Financial Statements and other sections in this Annual Report.

The Association is an institution of the Farm Credit System, which was created by Congress in 1916 and has served agricultural producers for almost 90 years. The System mission is to maintain and improve the income and well-being of American farmers, ranchers, and producers or harvesters of aquatic products and farm-related businesses. The Farm Credit System is the largest agricultural lending organization in the United States. The Farm Credit System is regulated by the Farm Credit Administration (FCA) which is an independent safety and soundness regulator.

The Association is a cooperative, which is owned by the members served. The territory of the Association extends across a diverse agricultural region of Alabama, Louisiana, and Mississippi. Refer to Note 1 of the Notes to the Consolidated Financial Statements for further description of the Association's territory. The Association provides credit to farmers, ranchers, rural residents, and agribusinesses. Our success begins with our extensive agricultural experience and knowledge of the market.

The Association obtains funding from AgFirst Farm Credit Bank (the Bank). The Association is materially affected by the financial condition and results of operations of the Bank. Copies of the AgFirst Farm Credit Bank's Quarterly and Annual Reports are on the AgFirst website, *www.agfirst.com,* or may be obtained at no charge by calling 1-800-845-1745, extension 378. Copies of the Association's quarterly reports are available on the Association's website, *www.firstsouthfarmcredit.com*, or may be obtained upon request free of charge by calling 1-800-955-1722 or writing Bryan Applewhite, First South Farm Credit, ACA, P. O. Box 6008, Ridgeland, MS 39158-6008.

ECONOMIC CONDITIONS

During 2004, economic conditions in our region were generally favorable, allowing for satisfactory loan performance within the overall loan portfolio. Even so, adverse weather conditions did have an impact in some areas, resulting in financial stress for borrowers affected by those conditions. It is not expected that these problems will have a material impact on overall credit quality within the Association. There has been little change in our market base over the past year. During 2004, the Association targeted certain segments of our business with hopes of increasing market share. Continued efforts are being made to expand services, increase public knowledge of our services and streamline our current delivery of products to enhance our existing portfolio.

LOAN PORTFOLIO

The Association provides funds to farmers, rural homeowners, and farm-related businesses for financing of short and intermediate-term loans through numerous product types.

The gross loan volume of the Association as of December 31, 2004, was $889,076, an increase of $49,165 or 5.85 percent as compared to $839,911 at December 31, 2003. Net loans outstanding (gross loans net of the allowance for loan losses) on December 31, 2004, were $883,887 as compared to $819,281 at December 31, 2003. Net loans accounted for 89.70 percent of total assets on December 31, 2004 as compared to 89.16 percent of total assets at December 31, 2003.

The geographic distribution of the loans is as follows:

State	12/31/04	12/31/03
Alabama	46.82%	48.06%
Louisiana	22.54	22.37
Mississippi	30.64	29.57
	100.00%	100.00%

The diversification of the Association loan volume by type is shown below:

Loan Type	12/31/04	12/31/03
Production and intermediate-term	94.93%	95.53%
Rural home	.33	.36
Farm-related business	1.17	1.74
Nonaccrual	.37	.47
Processing and marketing	.40	.34
Sales contracts	.05	.04
Other	—	.01
Participations purchased	7.73	5.87
Less: participations sold	(4.98)	(4.36)
	100.00%	100.00%

The Association's loan portfolio is diversified over a range of agricultural commodities in our region. Predominant commodities in the portfolio are poultry, cotton, livestock, and forestry that constitute over 69 percent of the entire portfolio.

	Percent of Portfolio		
Commodity Group	**2004**	**2003**	**2002**
Poultry	31%	32%	30%
Forestry	16	15	13
Cotton	14	13	14
Livestock	8	9	9
Sugar Cane	7	6	6
Catfish	5	5	7
Rice	4	3	3
Peanuts	2	2	3
Soybeans	2	2	2
Dairy	1	1	1
Other	10	12	12
Total	100%	100%	100%

Repayment ability is closely related to the commodities produced by our borrowers, and increasingly, the off-farm income of borrowers. The Association's loan portfolio contains a concentration of poultry, forestry, cotton, and livestock producers. Although a large percentage of the loan portfolio is concentrated in these enterprises, many of these operations are diversified within their enterprise and/or with crop production that reduces overall risk exposure. Demand for beef, prices of field grains, and international trade are some of the factors affecting the price of these commodities. Even though the concentration of large loans has increased over the past several years, the agricultural enterprise mix of these loans is diversified and similar to that of the overall portfolio. The risk in the portfolio associated with commodity concentration and large loans is reduced by the range of diversity of enterprises in the Association's territory.

Concentration of risk in the loan portfolio, whether by enterprise, individuals, or related parties, is managed through loan participations, underwriting standards, internal lending limits, and sound portfolio management and monitoring practices. As a part of these risk management strategies, the Association has entered into participation agreements with AgFirst and System entities. Please refer to Note 4 in the Notes to the Consolidated Financial Statements section of this Annual Report for additional information concerning the loan types and loan portfolio.

The increase in gross and net loan volume during the reporting period is primarily attributed to the growth in new loan volume across several commodity groups, especially forestry.

The Association's portfolio, which is heavily influenced by operating-type loans, normally reaches a peak balance in September and rapidly declines in the fall and winter months as commodities are marketed and proceeds are applied to repay operating loans.

During 2004, the Association increased activity in the buying and selling of loan participations within and outside of the Farm Credit System (FCS). This provides a means for the Association to spread credit concentration risk and realize non-patronage sourced interest and fee income, which may strengthen our capital position.

Loan Participations:

	2004	**2003**
Participations Purchased – FCS Institutions	$ 26,979	$ 34,514
Participations Purchased – Non-FCS Institutions	41,762	14,814
Participations Sold	(44,272)	(36,643)
Total	$ 24,469	$ 12,685

The Association's loan portfolio is divided into performing and high-risk categories. As a part of a system to evaluate the success of a loan, the Association continues to review the credit quality of the loan portfolio on an ongoing basis. The high-risk assets, including accrued interest, are detailed below:

	12/31/04	**12/31/03**
High-risk Assets		
Nonaccrual loans	$ 3,311	$ 3,965
Restructured loans	145	109
Accruing loans 90 days past due	—	10
Total high-risk loans	3,456	4,084
Other property owned	739	434
Total high-risk assets	$ 4,195	$ 4,518
Ratios		
Nonaccrual loans to total loans	.37%	.47%
High-risk assets to total assets	.43%	.49%

Nonaccrual loans represent all loans where there is a reasonable doubt as to the collection of principal and/or interest under the contractual terms of the loan. Nonaccrual loans decreased $654, or 16.49 percent in 2004. Of the $3,311 in nonaccrual volume at December 31, 2004, $752 or 22.71%, compared to 32.51% and 36.95% at December 31, 2003 and 2002, respectively, was current as to scheduled principal and interest payments, but did not meet all regulatory requirements to be transferred into accrual status.

Loan restructuring is available to financially distressed borrowers. Restructuring of loans occurs when the Association grants a concession to a borrower based on either a court order or good faith in a borrower's ability to return to financial viability. The concessions can be in the form of a modification of terms or rates, a compromise of amounts owed, or deed in lieu of foreclosure. Other receipts of assets and/or equity to pay the loan in full or in part are also considered restructured loans. The type of alternative financing structure chosen is based on minimizing the loss incurred by both the Association and the borrower.

Credit Quality

We review the credit quality of the loan portfolio on an on-going basis as part of our risk management practices. Each loan is classified according to the Uniform Classification System, which is used by all Farm Credit System institutions. Below are the classification definitions.

- *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 facts, conditions and values that make collection in full highly questionable.
- *Loss* – Assets are considered uncollectible.

The following table presents selected statistics related to the credit quality of loans including accrued interest at December 31.

	2004	2003
Acceptable & OAEM	97.79%	97.56%
Substandard	2.21	2.44
Doubtful	—	—
Loss	—	—
Total	100.00%	100.00%

Allowance for Loan Losses

During 2004, the Association completed its study to further refine the allowance for loan losses methodology taking into account recently issued guidance by the FCA, the System's regulator, as well as the Securities and Exchange Commission (SEC) and Federal Financial Institutions Examination Council. As a result of this study and the resulting refinements in methodology, during the fourth quarter of 2004, the Association recorded a $14,809 reversal of the allowance for loan losses.

The Association's allowance for loan losses methodology was adjusted and revised in the late 1980s to take into account the credit losses experienced in the mid-to-late 1980s, as a result of unusually adverse economic factors affecting American agriculture. Given the long cyclical nature of the agricultural economy, loss factors utilized to determine the allowance for loan losses subsequent to 1989 continued to reflect, to some extent, the loss history of the mid-to-late 1980s, which resulted in conservative estimates of the allowance for loan losses. The Association's allowance for loan losses methodology utilized throughout the period was in accordance with generally accepted accounting principles and was consistently applied.

While conservative in estimating the allowance for loan losses, the methodology used resulted in annual provisions for loan losses over the periods that reflected changes in credit quality and loss experience. Accordingly, the reserves provided in the mid-to-late 1980s have, in effect, remained part of the allowance for loan losses. The Association's allowance for loan losses methodology has consistently adhered to proper accounting policies, under the regulatory supervision of the FCA in its role as a "safety and soundness" regulator. It was the FCA's view that the allowance for loan losses should include among others, an assessment of: probable losses, historical loss experience and economic conditions.

In April 2004, the FCA issued an "Informational Memorandum" to System institutions regarding the criteria and methodologies that would be used in evaluating the adequacy of a System institution's allowance for loan losses. The Farm Credit Administration endorsed the direction provided by other bank regulators and the SEC and indicated the conceptual framework addressed in their guidance would be included as part of their examination process.

The refinement in methodology resulted in a calculated allowance for loan losses that was significantly less than the previously recorded balance due to revised loss factors that are more indicative of actual loss experience in recent years and current borrower analysis. The factors considered in determining the revised level of allowance for loan losses were generally based on recent historical charge-off experience adjusted for relevant environmental factors. The Association considered the following when adjusting the historical charge-offs experience:

- changes in credit risk classifications,
- changes in collateral values,
- changes in risk concentrations,
- changes in weather related conditions, and
- changes in economic conditions.

While the reversal had a significant impact on 2004 results of operations and the previously recorded allowance for loan losses, the refinement in methodology is not expected to have a significant impact on comparative results of operations in future periods. Additionally, the refinement in methodology did not have a significant impact on the level of the risk bearing capacity of the Association, generally referred to as "risk funds" (capital plus the allowance for loan losses), which totaled $207,852 at December 31, 2004 (23.38 percent of Association loans), as compared with $202,615 at December 31, 2003 (24.12 percent of Association loans).

The following table provides relevant information regarding the allowance for loan losses at December 31.

	2004	2003	2002
Allowance for loan losses	$ 5,189	$ 20,630	$ 20,717
Provision for (reversal of) loan losses	(14,809)	1,200	1,200
Net charge-offs/(recoveries)	632	1,287	111
Allowance for loan losses to loans	.58%	2.46%	2.45%
Allowance for loan losses to nonaccrual loans	156.72%	520.30%	562.50%
Allowance for loan losses to impaired loans	150.14%	505.14%	525.55%
Net charge-offs/(recoveries) to average loans	.07%	.15%	.01%

Please refer to Notes 2, 3 and 4 in the Notes to the Consolidated Financial Statements of this Annual Report for further information concerning the allowance for loan losses.

RESULTS OF OPERATIONS

Net income for the year ended December 31, 2004, totaled $30,306, an increase of $17,565 or 137.86 percent, as compared to $12,741 for the same period of 2003. Interest income for the year ended December 31, 2004, was $49,669, a decrease of $322 or .64 percent as compared to $49,991 for the same period of 2003. Interest income decreased by $901 for the period ended December 31, 2003, compared to December 31, 2002. Major components of the changes in net income for the past two years are outlined in the following table.

Changes in Net Income:

	2004-2003	2003-2002
Net income (prior year)	$ 12,741	$ 13,133
Increase (decrease) in net income due to:		
Interest income	(322)	(901)
Interest expense	412	2,947
Net interest income	90	2,046
Provision for loan losses	16,009	—
Noninterest income	1,947	581
Noninterest expense	(376)	(3,320)
Provision for income taxes	(105)	301
Total changes in income	17,565	(392)
Net income	$ 30,306	$ 12,741

Net interest income increased by $90 or .35 percent in 2004 compared to 2003. The Association's net interest income as a percentage of average earning assets was 2.98 percent on December 31, 2004, compared to 3.00 percent on December 31, 2003.

Interest income on nonaccrual loans for 2004, totaled $351, a decrease of $727, compared to $1,078 for 2003. Please refer to the Consolidated Five-Year Summary of Selected Financial Data in this Annual Report to review key financial ratios pertaining to earnings and net interest income. The sources of change in net interest income are illustrated, as follows:

Change in Net Interest Income:

	Volume*	Rate	Nonaccrual Income	Total
12/31/04 - 12/31/03				
Interest income	$ 359	$ 46	$ (727)	$ (322)
Interest expense	107	(519)	—	(412)
Change in net interest income	$ 252	$ 565	$ (727)	$ 90
12/31/03 - 12/31/02				
Interest income	$ 4,053	$ (5,424)	$ 470	$ (901)
Interest expense	2,277	(5,224)	—	(2,947)
Change in net interest income	$ 1,776	$ (200)	$ 470	$ 2,046

* *Volume variances can be the result of increased/decreased loan volume or from changes in the percentage composition of assets and liabilities between periods.*

A reversal of the provision for loan losses at December 31, 2004 resulted in a net credit of $14,809, compared to provision expense of $1,200 and $1,200 at December 31, 2003 and 2002, respectively. Please refer to the Allowance for Loan Losses section discussed above.

Noninterest income for the year ended December 31, 2004, was $10,928 as compared to $8,981 for the same period of 2003. The increase is primarily attributed to an increase in financially related service income of $58 and an increase in patronage refunds from the Bank of $2,428. The Association received $5,772 in a patronage refund and $2,790 in a special distribution from the Bank for the year ended December 31, 2004. The increases referenced were offset by a decrease in loan fees of $47, an increase in losses on other property owned of $451, and a decrease in other noninterest income of $41.

Noninterest expense increased $376 or 1.85 percent for December 31, 2004, as compared to the same period of 2003. Salaries and employee benefits increased by $886 or 6.35 percent. Benefits expense for 2004 was $4,962 compared to $4,651 for 2003. The Association, along with other participating entities in the District plans, adopted changes to its benefit plans effective January 1, 2003 in an effort to moderate future increases. Also contributing to the increase in operating expenses was an increase in other operating expenses of $251. The increases referenced were partially offset by a decrease in occupancy and equipment expense of $186 and a decrease in the Insurance Fund premium of $575.

The Association recorded a provision for income taxes of $754 for the year ended December 31, 2004, as compared to a provision of $649 for 2003.

A key factor in the growth of net income for future years will be continued improvement in net interest and noninterest income. Our goal is to generate earnings sufficient to fund operations, adequately capitalize the Association, and achieve an adequate rate of return for our members. To meet this goal, the agricultural economy must continue the improvement shown in recent years and the Association must meet certain objectives. These objectives are to attract and maintain high quality loan volume priced at competitive rates and to manage credit risk in our entire portfolio, while efficiently meeting the credit needs of our members.

LIQUIDITY AND FUNDING SOURCES

Liquidity

Liquidity management is the process whereby funds are made available to meet all financial commitments including the extension of credit, payment of operating expenses and payment of debt obligations. The Association receives access to funds through its borrowing relationship with AgFirst Farm Credit Bank (the Bank) and from income generated by operations. Sufficient liquid funds have been available to meet all financial obligations.

Funding Sources

The principal source of funds for the Association is the borrowing relationship established with 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, creating notes payable to the Bank. The notes payable are segmented into variable rate and fixed rate components. 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 December 31, 2004, were $759,497 as compared to $712,060 at December 31, 2003. The increase of 6.66 percent during the period is attributable to the increase in loan volume.

Funds Management

The Bank and the Association manage assets and liabilities to provide a broad range of loan products and funding options, which will permit the Association to be competitive in all interest rate environments. The primary objective of the asset/liability management process is to provide stable and rising earnings, while maintaining adequate capital levels by managing exposure to credit and interest rate risks.

Demand for loan types is a driving force in establishing a funds management strategy. The Association offers fixed and variable rate loan products that are marginally priced according to financial market rates. Variable rate loans may be indexed to either the Prime Rate or the 90-day London Interbank Offered Rate (LIBOR). Fixed rate loans are priced based on the current cost of Farm Credit debt of similar terms to maturity.

The majority of the interest rate risk in the Association balance sheet is transferred to the Bank through the notes payable structure. The Bank, in turn, actively utilizes funds management techniques to identify, quantify and control risk associated with the loan portfolio.

CAPITAL RESOURCES

Total members' equity at December 31, 2004, increased 11.36 percent to $202,663 from the December 31, 2003, total of $181,985. The increase was primarily attributed to net income, partially offset by cash patronage.

Total capital stock and participation certificates were $63,502 on December 31, 2004, compared to $63,099 on December 31, 2003. This .64 percent increase is attributed to the increase in the Association's loan volume.

The Association's capital ratios as of December 31 and the FCA minimum requirements follow:

	2004	2003	2002	Regulatory Minimum
Permanent Capital	13.59%	13.84%	13.51%	7.00%
Total Surplus	12.21%	12.46%	12.17%	7.00%
Core Surplus	9.38%	9.40%	9.16%	3.50%

At December 31, 2004, the Association's permanent capital ratio, average at-risk capital divided by average risk adjusted assets calculated in accordance with FCA regulations, exceeded the regulatory minimum of 7.00 percent. In addition to these regulatory requirements, the Association has established a permanent capital goal in excess of the 7.00 percent FCA minimum requirement. As of December 31, 2004, the Association met this goal.

PATRONAGE PROGRAM

Prior to the beginning of any fiscal year, the Association's Board of Directors, by adoption of a resolution, may obligate the Association to distribute to borrowers on a patronage basis all or any portion of available consolidated net earnings of the Association and its subsidiaries for such fiscal year or for that and subsequent fiscal years. Refer to Note 8 of the Notes to the Consolidated Financial Statements for more information concerning the patronage distributions. The Association distributed patronage refunds of $16,249 in 2004 and $14,534 in 2003.

YOUNG, BEGINNING, AND SMALL FARMERS AND RANCHERS PROGRAM

The Association's mission includes providing sound and constructive credit and related services to young, beginning and small (YBS) farmers and ranchers. Annual marketing goals are established to increase market share of loans to YBS farmers and ranchers. The Association has in place a flexible YBS program with policies and procedures that are designed to meet the needs of YBS farmers in the Association's territory. The use of government guarantee loan programs is encouraged as a method to enhance use and manage risk associated with YBS loans.

YBS farmers and ranchers are defined as:

Young Farmer: A farmer, rancher, or producer or harvester of aquatic products who is age 35 or younger as of the date the loan is originally made.

Beginning Farmer: A farmer, rancher, or producer or harvester of aquatic products who has 10 years or less farming or ranching experience as of the date loan is originally made.

Small Farmer: A farmer, rancher, or producer or harvester of aquatic products who normally generates less than $250 in annual gross sales of agricultural or aquatic products at the date the loan is originally made.

The following table outlines the loan volume and number of YBS loans in the loan portfolio as of December 31 for the Association.

	December 31, 2004	
	Number of Loans	Amount of Loans
Young	1,264	$ 124,682
Beginning	1,672	167,410
Small	5,070	344,754

For purposes of the above table, a loan could be included in more than one of the categories depending on the characteristics of the underlying borrower.

The Association currently has the following penetration in the young, beginning, and small farmer market in Alabama, Mississippi and Louisiana. As of December 31, 2004, the Association was doing business with 21.61 percent of the young farmers, 4.81 percent of the beginning farmers, and 4.77 percent of small farmers identified by the same census. This information was computed using demographic data from the USDA-NASS 2002 AgCensus covering the Association's territory.

The Association has adopted a market outreach program that generates participation and involvement by the Association personnel on behalf of the Association as a strategy to meet the Association's objectives and goals. The results of these outreach and educational programs are reported to the First South Farm Credit, ACA Board of Directors (Board) on an annual basis. The Board adopts an annual business plan that includes a budget recommended by management that is sufficient to carryout the Association's YBS mission and performance goals.

FORWARD LOOKING INFORMATION

Certain information included in this discussion constitutes forward-looking statements and information that are based upon management's belief as well as certain assumptions made by and information currently available to management. When used in this discussion, the words "anticipate," "project," "expect," "believe," and similar expressions are intended to identify forward-looking statements. Although management of the Association believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations and projections will prove to have been correct. Such forward-looking statements are subject to certain risks, uncertainties and assumptions. Should one or more of these risks materialize, or should such underlying assumptions prove to be incorrect, actual results may vary materially from those anticipated, projected, or expected. Among key factors that may have a direct bearing on the Association's operating results are fluctuations in the economy, the relative strengths and weaknesses in the agricultural credit sectors and in the real estate market, the actions taken by the Federal Reserve for the purpose of managing the economy, and the continued growth of the agricultural market consistent with recent historical experience.

Disclosure Required by Farm Credit Administration Regulations

Description of Business

Descriptions of the territory served, persons eligible to borrow, types of lending activities engaged in, financial services offered and related Farm Credit organizations are incorporated herein by reference to Note 1 to the consolidated financial statements, "Organization and Operations," included in this annual report to stockholders.

The description of significant developments that had or could have a material impact on earnings or interest rates to borrowers, acquisitions or dispositions of material assets, material changes in the manner of conducting the business, seasonal characteristics, and concentrations of assets, if any, is incorporated in "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in this annual report to stockholders.

Description of Property

The following table sets forth certain information regarding the properties of the reporting entity, all of which are located in Alabama, Mississippi and Louisiana:

Location	Description	Form of Ownership
713 S. Pear Orchard Rd. Ridgeland, MS	Administrative	Leased
713 S. Pear Orchard Rd. Ridgeland, MS	Division/Branch	Leased
700 Hwy. 80 West Demopolis, AL	Branch	Owned
2341 AL Hwy. 21 South Oxford, AL	Branch	Owned
1824 Eva Rd., NE Cullman, AL	Division/Branch	Owned
320 AL Hwy. 75 N Albertville, AL	Branch	Owned
30035 Hwy. 72 West Madison, AL	Branch	Owned
14390 South Market St. Moulton, AL	Branch	Owned
970 Hwy. 20 East Tuscumbia, AL	Branch	Owned
4210 McFarland Blvd. Northport, AL	Branch	Owned
1434 S. Union Ave. Ozark, AL	Branch	Owned
1401 Forest Ave. Montgomery, AL	Division/Branch	Owned
22 Henderson Highway Troy, AL	Branch	Leased
141 Lee St. Luverne, AL	Branch	Owned
209 E. Second St. Bay Minette, AL	Branch	Leased
5070 Boll Weevil Circle Enterprise, AL	Branch	Owned
1103 Bypass West Andalusia, AL	Branch	Owned
914 Van Buren Ave. Oxford, MS	Branch	Owned
Hwy. 9 North Calhoun City, MS	Branch	Owned
2216 S. Gloster St. Tupelo, MS	Branch	Owned
306 E. Jefferson St. Aberdeen, MS	Branch	Owned
103 Professional Plaza Greenwood, MS	Branch	Owned
203 Cossar Blvd. Charleston, MS	Branch	Owned
505 E. Second St. Clarksdale, MS	Branch	Owned
250 S. Shelby St. Greenville, MS	Branch	Owned
303 S. Sharpe St. Cleveland, MS	Branch	Owned
209 Second St. Indianola, MS	Branch	Owned
105 Church St. Belzoni, MS	Closed	Owned
306 N. Main St. Newton, MS	Branch	Owned
701 Haley Barbour Pky. Yazoo City, MS	Closed	Owned
501 Apache Drive McComb, MS	Branch	Owned
1350 N. Clark Magnolia, MS	Closed	Owned
749 Cosby St. Centreville, MS	Closed	Owned
1711 Hardy St. Hattiesburg, MS	Branch	Owned
728 Sawmill Rd. Laurel, MS	Branch	Owned
5057 Hwy. I-49 South Service Rd. Opelousas, LA	Division/Branch	Owned
222 N. Cedar Tallulah, LA	Branch	Owned
1211 S. Louisa Rayville, LA	Closed	Owned
109 Davis Lake Providence, LA	Branch	Owned
811 Jackson St. Winnsboro, LA	Branch	Owned
2308 S. MacArthur Dr. Alexandria, LA	Branch	Owned
321 South Main Marksville, LA	Branch	Owned
1007 Guy Dr. St. Martinville, LA	Branch	Owned
3206 South LA 13 Crowley, LA	Branch	Owned
407 N. Church Jennings, LA	Branch	Owned
4696 Hwy. 19 Zachary, LA	Branch	Owned

Location	Description	Form of Ownership
725 Hospital Rd. New Roads, LA	Branch	Owned
1001 N.W. Central Ave. Amite, LA	Branch	Owned
1725 St. Mary Hwy. Thibodaux, LA	Branch	Owned

Legal Proceedings

Information, if any, to be disclosed in this section is incorporated herein by reference to Note 13 to the consolidated financial statements, "Commitments and Contingencies," included in this annual report to stockholders.

Description of Capital Structure

Information to be disclosed in this section is incorporated herein by reference to Note 8 to the consolidated financial statements, "Members' Equity," included in this annual report to stockholders.

Description of Liabilities

The description of liabilities, contingent liabilities and intrasystem financial assistance rights and obligations to be disclosed in this section is incorporated herein by reference to Notes 2, 7, 11 and 13 to the consolidated financial statements included in this annual report to stockholders.

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

"Management's Discussion and Analysis of Financial Condition and Results of Operations," which appears in this annual report to stockholders and is to be disclosed in this section, is incorporated herein by reference.

Senior Officers

The following represents certain information regarding the senior officers of the Association:

Senior Officer	Position
Stephen L. Rochelle	President & Chief Executive Officer
Bryan Applewhite	Chief Financial Officer /Senior Vice President/Treasurer
Sells J. Newman, Jr.	Senior Vice President/Marketing
Randy Underwood	Senior Vice President/Chief Credit Officer
Roger Chappell	President, North Alabama Division
Cecil Corbello	President, Louisiana Division
John Barnard	President, Mississippi Division
Camp Powers	President, South Alabama Division

The business experience for the past five years for senior officers is with the Farm Credit System.

The total amount of compensation earned by all senior officers as a group during the years ended December 31, 2004, 2003 and 2002, is as follows:

Aggregate Number of Senior Officers	Year	Annual Salary	Annual Bonus	Total
Stephen L. Rochelle	2004	$204,920	$ 43,000	$247,920
Stephen L. Rochelle	2003	$197,510	$ 35,000	$232,510
Stephen L. Rochelle	2002	$188,100	$ 17,500	$205,600
7	2004	$780,965	$117,141	$898,106
7	2003	$735,000	$110,250	$845,250
7	2002	$673,230	$101,360	$774,590

The Association had an Incentive Plan for 2004. Association employees from branch office level down participate in Plan A based upon new business development and Plan C based upon lease income. Administrative employees at the division and administrative office do not participate in these two plans. Plan B of the Incentive Plan applies to all personnel including administrative. The plan runs for the 12-month calendar year and pays an incentive based upon bottom line profitability from operations. Employees share on a pro rata salary basis and branch level personnel are limited to a maximum of 17 percent of salaries and administrative personnel are limited to 15 percent of salaries. Incentives for senior officers are paid within 45 days of the year-end. Bonuses are shown in year earned which may be different than year of payment. Seven senior officers shared in the 2004 incentive.

Disclosure of the total compensation earned in 2004 by any senior officer, or to any other individual included in the total whose compensation exceeds $50,000, is available to stockholders upon request.

Directors

Directors and senior officers are reimbursed on an actual cost basis for all expenses incurred in the performance of official duties. Such expenses may include transportation, lodging, meals, tips, tolls, parking of cars, laundry, registration fees, and other expenses associated with travel on official business. A copy of the policy is available to shareholders of the Association upon request.

The aggregate amount of reimbursement for travel, subsistence and other related expenses for all directors as a group was $155,525 for 2004, $151,801 for 2003, and $139,605 for 2002.

Subject to approval by the board, the Association may allow directors honorarium of $200 for attendance at meetings, committee meetings, or special assignments and $50 for telephone conference calls. Total compensation paid to directors as a group was $108,800.

The following represents certain information regarding the directors of the Association:

Paul Clark, Chairman, has a row crop operation in Decatur, Alabama, which has been his primary operation for the past five years. He is also co-owner of Clark and Reed, an ag consulting firm. He is a member of the National Alliance of Independent Consultants, Registry of Environmental and Agricultural Professionals and member and president of Alabama Ag Consulting Association. During 2004, he served 15 days at Association board meetings and 22 days in other official activities, and was paid $6,800. His term of office expired December 31, 2004.*

William H. Voss, Vice Chairman, has cattle and timber operations in Pike and Amite Counties, Mississippi and owns a real estate and property management firm in McComb which has been his primary occupation for the past five years. He is a former agricultural commodities broker with Merrill Lynch, a member of the Pike County Chamber of Commerce and the Mississippi Forestry Association. He has also served as Chairman of the Mississippi Real Estate Commission and the Pike County Farm Service Committee. During 2004, he served 15 days at Association board meetings and 17 days in other official activities, and was paid $5,800. His term of office expired December 31, 2004.*

Larry Arnaud has a row crop operation near Arnaudville, Louisiana, which has been his primary operation for the past five years. He is a member of Louisiana Farm Bureau, Louisiana Soybean Association and National Soybean Association. During 2004, he served 13 days at Association board meetings and 20 days in other official activities, and was paid $6,600. His term of office is 2003-2005.

Billy G. Aron has a row crop and cattle operation in Houlka, Mississippi, which has been his primary operation for the past five years. He is a member of the Farm Bureau, Mississippi Cattlemen's Association and Houlka Lions Club. During 2004, he served 5 days at Association board meetings and 5 days in other official activities, and was paid $1,700. His term of office expired December 31, 2003.* Because of the age limitation, Mr. Aron was not eligible for re-election.

Billy Ross Brown has a timber operation in Oxford, Mississippi, which has been his primary operation for the past five years. He served on the First South PCA board for five years until he was appointed to the Farm Credit Administration Board in Washington, DC and completed his term in 1994 as Chairman of the FCA Board. During that time, he served as the first chairman of the FCSIC board. Mr. Brown is a graduate of the University of Mississippi and is former chairman of the Mississippi Soil and Water Conservation Commission, and a member of Mississippi Association of Soil Conservation Districts. During 2004, he served 13 days at Association board meetings and 16 days in other official activities, and was paid $5,500. His term of office expired December 31, 2004.* Because of the age limitation, Mr. Brown was not eligible for re-election.

John R. Burden has a dairy operation in Baileyton, Alabama, which has been his primary operation for the past five years. He is a member of Patron Council for Goldkist and former director of DHIA. During 2004, he served 9 days at Association board meetings and 9 days in other official activities, and was paid $4,000. His term of office is 2004 – 2006.

Dr. Marty J. Fuller serves as the board appointed director and is not a member of the Association. He is the Director of Federal Relations for Mississippi State University (MSU) and serves as the primary MSU contact with Congress and federal agencies. Prior to this role he served as the Associate Director of the Mississippi Agricultural & Forestry Experiment Station (MAFES). Dr. Fuller is also a Professor in the Department of Agricultural Economics at Mississippi State University. He received his B.S, M.S. and Ph.D. degrees in Agricultural Economics from MSU. During 2004, he served 13 days at Association board meetings and 13 days in other official activities, and was paid $4,600. His term of office is April 1, 2002 – March 31, 2005.

William T. (Bill) Kyser, a resident of Hale County, Alabama, has a catfish, beef cattle and timber operation. He has served as a director for Catfish Farmers of America, Alabama Farmers Federation, Auburn Agricultural Alumni Association, Greensboro Farmers Cooperative, and Hale County Cattlemen's Association. During 2004, he served 13 days at Association board meetings and 10 days in other official activities, and was paid $4,000. His term of office expired December 31, 2004.*

R. K. Laird has a row crop operation in Tallulah, Louisiana, which has been his primary operation for the past five years. He serves as president of Farmers Gin and as an advisory director of Hibernia National Bank and Madison Parish Farm Bureau. During 2004, he served 4 days at Association board meetings and 3 days in other official activities, and was paid $1,100. His term of office expired December 31, 2003.* Because of the age limitation, Mr. Laird was not eligible for re-election.

Alan Marsh is a partner of Marsh Farms, a 3,000-acre family farming operation consisting of 2,000 acres of cotton, along with corn, soybeans, and wheat. He is a director of the Limestone Farmers' Federation and President of South Limestone Gin. During 2004, he served 13 days at Association board meetings and 16 days in other official activities, and was paid $5,650. His term of office expired December 31, 2004.*

James F. Martin, Jr. has a dairy and row crop operation in Enterprise, Alabama, which has been his primary operation for the past five years. He is a member and director of the Coffee County Farmers Cooperative. During 2004, he served 12 days at Association board meetings and 16 days in other official activities, and was paid $5,450. His term of office is 2004 - 2006.

Daniel Mattingly is the Agricultural Manager for Lula-Westfield, L.L.C. Lula Factory Division (raw sugar factory). He also manages 9,500 acres of farmland owned by Savoie Industries, Inc., and is the voting member of the company for First South. Mr. Mattingly serves as treasurer of Assumption Parish Farm Bureau where he has been a member for eight years. He is a member and secretary of the Board of Directors of Savoie Industries, having served on that board for the past five years. He is active in the Assumption Area Chamber of Commerce, Knights of Columbus, and is Vice President of West Ascension Recreation Board. During 2004, he served 6 days at Association board meetings and 12 days in other official activities, and was paid $3,600. His term of office is 2004-2006.

Joe H. Morgan has a 2,300-acre row crop operation consisting of cotton and peanuts. A member and former officer and director of Forrest County Farm Bureau, he also serves as chairman of the Forrest County FSA Committee, and is a member of Staplecotn Advisory Committee. Mr. Morgan is a former recipient of the Outstanding Young Farmer of the Year Award and the Outstanding Farmer Award for Outstanding Service in soil and Water Conservation. During 2004, he served 9 days at Association board meetings and 5 days in other official activities, and was paid $2,800. His term of office is 2004 – 2006.

Shepherd (Shep) Morris has a 2,400-acre cotton and grain operation. He serves as a board member of Autauga Quality Cotton Association and the Alabama Farmers Federation. He is a supervisor for Macon County Soil and Water District, vice president of Milstead Farm Group, Inc., and serves on the National Cotton Council. During 2004, he served 15 days at Association board meetings and 17 days in other official activities, and was paid $5,950. His term of office is 2003-2005.

Thomas H. Nelson, Jr. has a row crop operation in Chatham, Mississippi, which has been his primary operation for the past five years. He is a director and officer of Washington County Farm Bureau. During 2004, he served 10 days at Association board meetings and 15 days in other official activities, and was paid $4,700. His term expired December 31, 2004.*

James M. Norsworthy, III has a row crop and cattle operation near Jackson, Louisiana, which has been his primary operation for the past five years. He serves as an officer/member of the Farm Bureau and Jackson Baseball Association, and a member of Jackson Assembly and Forestry Association. During 2004, he served 15 days at Association board meetings and 14 days in other official activities, and was paid $5,500. His term of office expired December 31, 2004.*

Thomas A. Parker has a 4,000-acre farming operation in Lake Providence, Louisiana, consisting of cotton, corn, rice and soybeans. He also manages an 8,000-acre farm in Arkansas, and is part owner of 300 acres of catfish ponds in Arkansas. Mr. Parker serves as a director on Hibernia Bank City Board and on the Staplcotn Board. He is the Louisiana member on the Cotton Board, President of East Carroll Farm Bureau and President of Louisiana Cotton Producers. During 2004, he served 8 days at Association board meetings and 4 days in other official activities, and was paid $2,400. His term of office is 2004-2006.

Ted S. Passmore's primary operation for the past five years has been 5,000 acres in a row crop general partnership with his brother in Deville, Louisiana. He is a member of Louisiana Farm Bureau. During 2004, he served 15 days at Association board meetings and 18 days in other official activities, and was paid $5,700. His term of office is 2003-2005.

W. S. Patrick has a cotton and soybean operation in Canton, Mississippi, which has been his primary operation for the past five years. He is part owner of the Madison-Rankin Gin, a director and officer of the Madison County Cooperative, and Madison County FSA. During 2004, he served 15 days at Association board meetings and 13 days in other official activities, and was paid $4,850. His term of office is 2003-2005.

Robert E. Potts has a 175 cow dairy operation on 400 acres in Tangipahoa Parish, Louisiana. He is a member of Dairy Farmers of America, Farm Bureau and Spring Creed Masonic Lodge. He is also a board member of Tangipahoa Parish School System. During 2004, he served 12 days at Association board meetings and 8 days in other official activities, and was paid $3,850. His term of office is 2003-2005.

Walter R. Richardson's primary operation for the past five years has been row crop and cattle in Leroy, Alabama. He serves on the Washington County Soil Conservation board and is a director of Alabama Farmers Federation and past President of the Washington County Cattlemen's Association. During 2004, he served 12 days at Association board meetings and 17 days in other official activities, and was paid $5,500. His term of office is 2003-2005.

D. Derwood Strain has a row crop and aquaculture operation in Greenwood, Mississippi, which has been his primary operation for the past five years. He is a member of the Greenwood Farmers Club and Leflore County Farm Bureau. Mr. Strain is a stockholder of Ag Concepts, Inc., and Leflore Hardware, Inc. During 2004, he served 17 days at Association board meetings and 9 days in other official activities, and was paid $4,900. His term of office is 2003-2005.

Mike Unkel has a rice, soybean and cattle operation in Kinder, Louisiana, which has been his primary operation for the past five years. He is a member of Allen Parish Rice Growers and Allen Parish Cattlemen's Association, president of Allen Parish ASCS and Allen Action Agency. Mr. Unkel serves as president of Kinder Canal Company, Kinder Bean Elevator, Kinder Liquid Fertilizer, and Kinder Farm Supply. During 2004, he served 13 days at Association board meetings and 9 days in other official activities, and was paid $4,250. His term of office expired December 31, 2004.*

Dan West has a row crop and timber operation in Monroe County, Mississippi, consisting of 2,500 acres cropland and 1,100 acres of timber. Mr. West is part owner of Hamilton Electric Gin and Warehouse. He is a member of Southern Ginners Association, and is a regional director of Staplcotn. He has served on the board of Monroe County Farm Bureau, Mississippi Bollweevil Management Corporation and is past president of the Mississippi Ginners Association. During 2004, he served 9 days at Association board meetings and 9 days in other official activities, and was paid $3,600. His term of office is 2004-2006.

* *Directors serve through the annual meeting following the expiration of their term.*

Transactions with Senior Officers and Directors

The reporting entity's policies on loans to and transactions with its officers and directors, to be disclosed in this section are incorporated herein by reference to Note 12 to the consolidated financial statements, "Related Party Transactions," included in this annual report to stockholders.

Involvement in Certain Legal Proceedings

There were no matters which came to the attention of management or the board of directors regarding involvement of current directors or senior officers in specified legal proceedings which should be disclosed in this section.

Relationship with Independent Public Accountants

There were no material disagreements with our independent public accountants on any matter of accounting principles or financial statement disclosure during this period.

Consolidated Financial Statements

The consolidated financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated March 4, 2005, and the report of management, which appear in this annual report to stockholders are incorporated herein by reference.

Copies of the Association's quarterly reports are available upon request free of charge by calling 1-888-297-1722, or writing to Bryan Applewhite, P.O. Box 6008, Ridgeland, MS 39158-6008.

Borrower Information Regulations

Since 1972, Farm Credit Administration (FCA) regulations have required that borrower information be held in strict confidence by Farm Credit System (FCS) institutions, their directors, officers and employees. These regulations provide Farm Credit institutions clear guidelines for protecting their borrowers' nonpublic personal information.

On November 10, 1999, the FCA Board adopted a policy that requires FCS institutions to formally inform new borrowers at loan closing of the FCA regulations on releasing borrower information and to address this information in the annual report to shareholders. The implementation of these measures ensures that new and existing borrowers are aware of the privacy protections afforded them through FCA regulations and Farm Credit System institution efforts.

Stockholder Investment

Stockholder investment in the Association could be affected by the financial condition and results of operations of AgFirst Farm Credit Bank. Copies of the District annual and quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 378, or writing Jay Wise, AgFirst Farm Credit Bank, P. O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained by going to AgFirst's website at *www.agfirst.com*.

Audit Committee Report

The Audit Committee of the Board of Directors (the Committee) is comprised of the directors named below. None of the directors who serve on the Audit Committee is an employee of First South Farm Credit, ACA (the Association) and in the opinion of the Board of Directors, each is free of any relationship with the Association or management that would interfere with the director's independent judgment on the committee.

The Committee has adopted a written charter that has been approved by the Board of Directors. The Committee has reviewed and discussed the Association's audited financial statements with management, which has primary responsibility for the financial statements.

PricewaterhouseCoopers LLP (PwC), the Association's independent auditor for 2004, is responsible for expressing an opinion on the conformity of the Association's audited financial statements with generally accepted accounting principles. The Committee has discussed with PwC the matters that are required to be discussed by Statement on Auditing Standards No. 61 *(Communication With Audit Committees)*. PwC has provided to the Committee the written disclosures and the letter required by Independence Standards Board Standard No. 1 *(Independence Discussions with Audit Committees)*, and the Committee has discussed with PwC that firm's independence.

The Committee has also concluded that PwC's provision of non-audit services to the Association is compatible with PwC's independence.

Based on the considerations referred to above, the Committee recommended to the Board of Directors that the audited financial statements be included in the Association's Annual Report for 2004. The foregoing report is provided by the following independent directors, who constitute the Audit Committee:

Marty J Fuller

Dr. Marty J. Fuller
Chairman of the Audit Committee

Members of Audit Committee

Paul Clark
James M. Norsworthy, III
W.S. Patrick

Report of Independent Auditors

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers LLP
10 Tenth Street, Suite 1400
Atlanta, GA 30309
Telephone (678) 419 1000

Report of Independent Auditors

March 4, 2005

To the Board of Directors and Stockholders
of First South Farm Credit, ACA

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of changes in members' equity and of cash flows present fairly, in all material respects, the financial position of First South Farm Credit, ACA and its subsidiaries at December 31, 2004, 2003 and 2002, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2004 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

Consolidated Balance Sheets

(dollars in thousands)	December 31, 2004	December 31, 2003	December 31, 2002
Assets			
Cash	$ 10,375	$ 10,372	$ 11,455
Loans	889,076	839,911	844,501
Less: allowance for loan losses	5,189	20,630	20,717
Net loans	883,887	819,281	823,784
Accrued interest receivable	9,504	8,593	10,067
Investment in other Farm Credit institutions	61,513	62,314	63,705
Premises and equipment, net	3,897	3,280	3,260
Other property owned	739	434	56
Deferred tax asset, net	—	283	288
Other assets	15,641	14,282	14,533
Total assets	$ 985,556	$ 918,839	$ 927,148
Liabilities			
Notes payable to AgFirst Farm Credit Bank	$ 759,497	$ 712,060	$ 724,781
Accrued interest payable	2,253	1,901	2,178
Patronage refund payable	3,105	2,803	3,729
Postretirement benefits other than pensions	11,204	10,472	10,015
Other liabilities	6,834	9,618	9,472
Total liabilities	782,893	736,854	750,175
Commitments and contingencies			
Members' Equity			
Protected borrower equity	142	147	147
Capital stock and participation certificates	63,360	62,952	62,260
Retained earnings			
Allocated	58,064	52,081	46,056
Unallocated	81,097	66,805	68,510
Total members' equity	202,663	181,985	176,973
Total liabilities and members' equity	$ 985,556	$ 918,839	$ 927,148

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

Consolidated Statements of Income

(dollars in thousands)	For the year ended December 31, 2004	2003	2002
Interest Income			
Loans	$ 49,669	$ 49,991	$ 50,892
Interest Expense			
Notes payable to AgFirst Farm Credit Bank	23,686	24,097	27,042
Other	8	9	11
Total interest expense	23,694	24,106	27,053
Net interest income	25,975	25,885	23,839
Provision for (reversal of) loan losses	(14,809)	1,200	1,200
Net interest income after provision for (reversal of) loan losses	40,784	24,685	22,639
Noninterest Income			
Loan fees	1,977	2,024	1,810
Fees for financially related services	643	585	735
Patronage refund from other Farm Credit institutions	8,562	6,134	5,644
Gains (losses) on other property owned, net	(351)	100	62
Other noninterest income	97	138	149
Total noninterest income	10,928	8,981	8,400
Noninterest Expense			
Salaries and employee benefits	14,845	13,959	11,206
Occupancy and equipment	1,142	1,328	1,281
Insurance Fund premium	423	998	238
Other operating expenses	4,242	3,991	4,231
Total noninterest expense	20,652	20,276	16,956
Income before income taxes	31,060	13,390	14,083
Provision (benefit) for income taxes	754	649	950
Net income	$ 30,306	$ 12,741	$ 13,133

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

Consolidated Statements of Changes in Members' Equity

(dollars in thousands)	Protected Borrower Equity	Capital Stock and Participation Certificates	Retained Earnings Allocated	Retained Earnings Unallocated	Total Members' Equity
Balance at December 31, 2001	$ 175	$ 61,448	$ 41,390	$ 70,414	$ 173,427
Net income				13,133	13,133
Protected borrower equity retired	(28)				(28)
Capital stock/participation certificates issued		1,922			1,922
Capital stock/participation certificates retired		(1,110)			(1,110)
Patronage distribution					
Cash				(3,727)	(3,727)
Qualified allocated surplus			5,591	(5,591)	—
Nonqualified allocated surplus			2,244	(2,244)	—
Nonqualified retained surplus			3,485	(3,485)	—
Retained earnings retired			(6,660)		(6,660)
Distribution adjustment			6	10	16
Balance at December 31, 2002	147	62,260	46,056	68,510	176,973
Net income				12,741	12,741
Capital stock/participation certificates issued		1,936			1,936
Capital stock/participation certificates retired		(1,244)			(1,244)
Patronage distribution					
Cash				(2,800)	(2,800)
Qualified allocated surplus			4,199	(4,199)	—
Nonqualified allocated surplus			3,069	(3,069)	—
Nonqualified retained surplus			4,466	(4,466)	—
Retained earnings retired			(5,669)		(5,669)
Distribution adjustment			(40)	88	48
Balance at December 31, 2003	147	62,952	52,081	66,805	181,985
Net income				30,306	30,306
Protected borrower equity retired	(5)				(5)
Capital stock/participation certificates issued		1,600			1,600
Capital stock/participation certificates retired		(1,192)			(1,192)
Patronage distribution					
Cash				(3,101)	(3,101)
Qualified allocated surplus			4,652	(4,652)	—
Nonqualified allocated surplus			3,845	(3,845)	—
Nonqualified retained surplus			4,651	(4,651)	—
Retained earnings retired			(7,004)		(7,004)
Distribution adjustment			(161)	235	74
Balance at December 31, 2004	$ 142	$ 63,360	$ 58,064	$ 81,097	$ 202,663

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

Consolidated Statements of Cash Flows

(dollars in thousands)	For the year ended December 31, 2004	2003	2002
Cash flows from operating activities:			
Net income	$ 30,306	$ 12,741	$ 13,133
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation on premises and equipment	344	330	298
Provision for (reversal of) loan losses	(14,809)	1,200	1,200
(Gains) losses on other property owned, net	351	(100)	(62)
(Gains) losses from sale of premises and equipment, net	—	(30)	—
Changes in operating assets and liabilities:			
(Increase) decrease in accrued interest receivable	(911)	1,474	(431)
(Increase) decrease in deferred tax asset, net	283	5	162
(Increase) decrease in other assets	(1,359)	251	(1,382)
Increase (decrease) in accrued interest payable	352	(277)	(80)
Increase (decrease) in postretirement benefits other than pensions	732	457	(22)
Increase (decrease) in other liabilities	(2,784)	146	62
Total adjustments	(17,801)	3,456	(255)
Net cash provided by (used in) operating activities	12,505	16,197	12,878
Cash flows from investing activities:			
Net (increase) decrease in loans	(50,713)	1,864	(135,742)
(Increase) decrease in investment in other Farm Credit institutions	801	1,391	1,229
Purchase of premises and equipment, net	(1,501)	(379)	(223)
Proceeds from sale of premises and equipment, net	540	59	—
Proceeds from sale of other property owned	260	1,161	154
Net cash provided by (used in) investing activities	(50,613)	4,096	(134,582)
Cash flows from financing activities:			
Advances on (repayment of) notes payable to AgFirst Farm Credit Bank, net	47,437	(12,721)	130,540
Protected borrower equity retired	(5)	—	(28)
Capital stock and participation certificates issued	1,600	1,936	1,922
Capital stock and participation certificates retired	(1,192)	(1,244)	(1,110)
Patronage refunds paid	(2,725)	(3,678)	(3,669)
Retained earnings retired	(7,004)	(5,669)	(6,660)
Net cash provided by (used in) financing activities	38,111	(21,376)	120,995
Net increase (decrease) in cash	3	(1,083)	(709)
Cash, beginning of period	10,372	11,455	12,164
Cash, end of period	$ 10,375	$ 10,372	$ 11,455
Supplemental schedule of non-cash investing and financing activities:			
Loans transferred to other property owned	$ 916	$ 1,439	$ 103
Cash dividends or patronage distributions declared or payable	3,101	2,800	3,727
Supplemental information:			
Interest paid	$ 23,342	$ 24,383	$ 27,133
Taxes paid, net	526	913	102

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

Notes to the Consolidated Financial Statements

(dollars in thousands, except as noted)

Note 1 — Organization and Operations

A. **Organization:** First South Farm Credit, ACA (the Association) is a member-owned cooperative which provides credit and credit-related services to or for the benefit of eligible borrowers/stockholders for qualified agricultural purposes in the states of Alabama and Mississippi, Marion County in the state of Tennessee, and all but certain parishes within the northwestern portion of Louisiana.

The Association is a lending institution of the Farm Credit System (the System), a nationwide system of cooperatively owned Banks and Associations, which was established by Acts of Congress to meet the credit needs of American agriculture and is subject to the provisions of the Farm Credit Act of 1971, as amended (the Farm Credit Act). The most recent significant amendment to the Farm Credit Act was the Agricultural Credit Act of 1987. At December 31, 2004, the System was comprised of four Farm Credit Banks and one Agricultural Credit Bank and numerous Associations.

AgFirst Farm Credit Bank (Bank) and its related Associations are collectively referred to as the "District." The Bank provides funding to all associations within the District and is responsible for supervising certain activities of the District Associations, as well as the other associations operating within the AgFirst District. The District consists of the Bank and twenty-three ACAs, twenty-one of which have reorganized as ACA parent-companies, which have two wholly owned subsidiaries, an FLCA and a PCA. Effective January 1, 2005, the two remaining Associations have reorganized as ACA holding companies.

The Association makes short- and intermediate-term loans for agricultural production or operating purposes and secured real estate loans.

The Farm Credit Administration (FCA) is delegated authority by Congress to regulate the System banks and associations. The activities of the associations are examined by the FCA and certain actions by the associations are subject to the prior approval of the FCA and the supervising Bank.

The Farm Credit Act established the Farm Credit System Insurance Corporation (Insurance Corporation) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is required to be used (1) to ensure the timely payment of principal and interest on Systemwide debt obligations (Insured debt), (2) to ensure the retirement of protected borrower capital at par or stated value, and (3) for other specified purposes. The Insurance Fund is also available for discretionary uses by the Insurance Corporation of providing assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation. Each System bank is required to pay premiums into the Insurance Fund, based on its annual average loan principal outstanding until the monies in the Insurance Fund reach the "secure base amount," which is defined in the Farm Credit Act as 2.0 percent of the aggregate insured obligations (Systemwide debt obligations). When the amount in the Insurance Fund exceeds the secure base amount, the Insurance Corporation is required to reduce premiums, but it still must ensure that reduced premiums are sufficient to maintain the level of the Insurance Fund at the secure base amount.

B. **Operations:** The Farm Credit Act sets forth the types of authorized lending activity, persons eligible to borrow, and financial services which can be offered by the Association. The Association is authorized to provide, either directly or in participation with other lenders, credit, credit commitments and related services to eligible borrowers. Eligible borrowers include farmers, ranchers, producers or harvesters of aquatic products, rural residents, and farm-related businesses.

The Association may sell to any Farm Credit borrowing member, on an optional basis, credit or term life insurance appropriate to protect the loan commitment in the event of death of the debtor(s). The sale of other insurance necessary to protect a member's farm or aquatic unit is permitted, but limited to hail and multi-peril crop insurance, and insurance necessary to protect the facilities and equipment of aquatic borrowers.

Upon request, stockholders of the Association will be provided with an AgFirst Farm Credit Bank Annual Report to Stockholders, which includes the combined financial statements of the Bank and its related Associations. The Association's financial condition may be impacted by factors that affect the Bank. The AgFirst Annual Report discusses the material aspects of the District's financial condition, changes in financial condition, and results of operations. In addition, the AgFirst Annual Report identifies favorable and unfavorable trends, significant events, uncertainties and the impact of activities of the Financial Assistance Corporation Assistance Board (Assistance Board) and Insurance Corporation.

The lending and financial services offered by the Bank are described in Note 1 of the District's Annual Report to Stockholders.

Note 2 — Summary of Significant Accounting Policies

The accounting and reporting policies of the Association conform with accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Significant estimates are discussed in these footnotes, as applicable. Actual results may differ from these estimates.

Certain amounts in prior years' financial statements have been reclassified to conform to current consolidated financial statement presentation. Such reclassifications had no effect on net income or total members' equity of prior years. The consolidated financial statements include the accounts of the FLCA and the PCA. All significant inter-company transactions have been eliminated in consolidation.

A. **Cash:** Cash, as included in the statement of cash flows, represents cash on hand and on deposit at banks.

B. **Loans and Allowance for Loan Losses:** Substantially all short- and intermediate-term loans for agricultural production or operating purposes have maturities of 10 years or less.

Loans are carried at their principal amount outstanding less unearned income. Interest on loans is accrued and credited to interest income based upon the principal amount outstanding. Loans are generally placed in nonaccrual status when principal or interest is delinquent for 90 days or more (unless adequately secured and in the process of collection) or circumstances indicate that collection of principal and/or interest is in doubt. When a loan is placed in nonaccrual status, accrued interest deemed uncollectible is reversed (if accrued in the current year) or charged against the allowance for loan losses (if accrued in prior years).

When loans are in nonaccrual status, the interest portion of payments received in cash is generally recognized as interest income if collection of the recorded investment in the loan is fully expected and the loan does not have a remaining unrecovered prior charge-off associated with it. Otherwise, loan payments are applied against the recorded investment in the loan asset. Nonaccrual loans may be transferred to accrual status when principal and interest are current, prior charge-offs have been recovered, the ability of the borrower to fulfill the contractual repayment terms is fully expected and the loan is not classified "doubtful" or "loss."

In cases where a borrower experiences financial difficulties and the Association makes certain monetary concessions to the borrower through modifications to the contractual terms of the loan, the loan is classified as a restructured loan. If the borrower's ability to meet the revised payment schedule is uncertain, the loan is classified as a nonaccrual loan.

The allowance for loan losses is a valuation account used to reasonably estimate loan and lease losses existing as of the financial statement date. Determining the appropriate allowance for loan losses balance involves significant judgment about when a loss has been incurred and the amount of that loss. The determination of the allowance for loan losses is based on management's current judgments about the credit quality of its loan and lease portfolio. A specific allowance may be established for impaired loans under SFAS No. 114. Impairment of these loans is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as practically expedient, at the loan's observable market price or fair value of the collateral if the loan is collateral dependent. See Note 3 for a discussion on the refinement of the allowance for loan losses methodology.

The allowance for loan losses is maintained at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio. The allowance is increased through provisions for loan losses and loan recoveries and is decreased through reversals of provisions for loan losses and loan charge-offs.

The allowance is based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including economic conditions, loan portfolio composition and prior loan loss experience. It is based on estimates, appraisals and evaluations of loans which, by their nature, contain elements of uncertainty and imprecision. The possibility exists that changes in the economy and its impact on borrower repayment capacity will cause these estimates, appraisals and evaluations to change.

The level of allowance for loan losses is generally based on recent charge-off experience adjusted for relevant environmental factors. The Association considers the following factors when adjusting the historical charge-offs experience:

- Changes in credit risk classifications,
- Changes in collateral values,
- Changes in risk concentrations,
- Changes in weather related conditions, and
- Changes in economic conditions.

C. **Investment in AgFirst Farm Credit Bank and Other Farm Credit Institutions:** The Association is required to maintain ownership in the Bank in the form of Class C stock. Accounting for this investment is on the cost plus allocated equities basis. Patronage refunds from the Bank are accrued as earned. The receivable for such patronage refunds is included in other assets.

D. **Other Property Owned:** Other property owned, consisting of real and personal property acquired through a collection action, is recorded at fair value less estimated selling costs upon acquisition. Revised estimates to the fair value less cost to sell are reported as adjustments to the carrying amount of the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Income and expenses from operations and carrying value adjustments are included in gains (losses) on other property owned.

E. **Premises and Equipment:** Premises and equipment are carried at cost less accumulated depreciation. Depreciation is provided on the straight-line method over the estimated useful lives of the assets. Gains and losses on dispositions are reflected in current operations. Maintenance and repairs are charged to operating expense and improvements are capitalized.

F. **Advanced Conditional Payments:** The Association is authorized under the Farm Credit Act to accept advance payments from borrowers. To the extent the borrower's access to such advance payments is restricted, the advanced conditional payments are netted against the borrower's related loan balance. Amounts in excess of the related loan balance and amounts to which the borrower has unrestricted access are presented as interest-bearing liabilities in the accompanying Balance Sheet. Advanced conditional payments are not insured. Interest is generally paid by the Association on such accounts.

G. **Employee Benefit Plans:** The employees of the Association participate in a defined benefit retirement plan. The "Projected Unit Credit" actuarial method is used for financial reporting purposes and the "Entry-Age Normal Cost" method for funding purposes. As a result of the funded status at the Plan's measurement date (September 30) of the underlying Plan, the Association may record a minimum liability, an intangible asset relating to unrecognized prior service cost and other comprehensive income (loss). The adjustment to other comprehensive income (loss) would be net of deferred taxes, if significant.

   The employees of the Association are eligible to participate in the District's thrift/deferred compensation plan (Thrift Plan); a percentage of employee contributions is matched by the Association. Thrift Plan costs are expensed as funded.

   The Association provides certain health care and life insurance benefits to eligible retired employees. Substantially all employees may become eligible for these benefits if they reach normal retirement age while working for the Association. Expenses of $1,163, $963 and $563 for the years ended December 31, 2004, 2003 and 2002, respectively, were classified as salaries and employee benefits.

H. **Income Taxes:** The Association is generally subject to Federal and certain other income taxes. The Association is eligible to operate as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, the Association 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 taxable earnings that will not be distributed as qualified patronage refunds. The Association distributes patronage on the basis of book income. The Association recognizes deferred tax assets and liabilities for the expected future tax consequences of the temporary differences between the carrying amounts and tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be realized or settled.

I. **Patronage Refund from AgFirst and Other Financial Institutions:** The Association records patronage refunds from the Bank and certain District Associations on an accrual basis.

Note 3 – Refinement of the Allowance for Loan Losses Methodology

During 2004, the Association conducted a study to further refine its allowance for loan losses methodology taking into account recently issued guidance by FCA, the System's regulator, as well as the Securities and Exchange Commission (SEC) and Federal Financial Institutions Examination Council guidelines.

The Association's allowance for loan losses methodology was adjusted and revised in the late 1980s to take into account credit losses in that period. Given the long cyclical nature of the agricultural economy, loss factors utilized to determine the allowance for loan losses subsequent to 1989 continued to reflect, to some extent, the loss history of the mid-to-late 1980s, which resulted in conservative estimates of the allowance for loan losses. The Association's allowance for loan losses methodology utilized throughout the period was in accordance with generally accepted accounting principles and was consistently applied.

While conservative in estimating the allowance for loan losses, the methodology used resulted in annual provisions for loan losses over the periods that reflected changes in credit quality and loss experience. Accordingly, the reserves provided in the mid-to-late 1980s have, in effect, remained part of the allowance for loan losses. The Association's allowance for loan losses methodology has consistently adhered to proper accounting policies, under the regulatory supervision of FCA in its role as a "safety and soundness" regulator. It was FCA's view that the allowance for loan losses should include among others, an assessment of probable losses, historical loss experience and economic conditions.

In April 2004, FCA issued an "Informational Memorandum" to System institutions regarding the criteria and methodologies that would be used in evaluating the adequacy of a System institution's allowance for loan losses. FCA endorsed the direction provided by other bank regulators and the SEC and indicated the conceptual framework addressed in their guidance would be included as part of their examination process.

During the fourth quarter of 2004, the Association completed its study and refined its methodology to be in compliance with the guidance discussed in the previous paragraph. The refinement in methodology resulted in a calculated allowance for loan losses that was significantly less than the previously recorded balance due to revised loss factors that are more indicative of actual loss experience in recent years and current borrower analysis.

While the $14,809 reversal had a significant impact on 2004 results of operations and the previously recorded allowance for loan losses, the refinement in methodology is not expected to have a significant impact on comparative results of operations in future periods. Additionally, the refinement in methodology did not have a significant impact on the level of the risk bearing capacity of the Association, generally referred to as "risk funds" (capital plus the allowance for loan losses), which totaled $207,852 at December 31, 2004 (23.38 percent of Association loans), as compared with $202,615 at December 31, 2003 (24.12 percent of Association loans).

Note 4 — Loans and Allowance for Loan Losses

A summary of loans follows:

	December 31, 2004	2003	2002
Production and intermediate-term	$ 843,995	$ 802,366	$ 818,843
Rural home	2,932	3,038	1,808
Farm related business	10,363	14,621	10,061
Processing and marketing	3,537	2,819	957
Sales contracts	469	332	141
Nonaccruals	3,311	3,965	3,683
Other	—	85	160
Plus: participations purchased	68,741	49,328	35,463
Less: participations sold	(44,272)	(36,643)	(26,615)
Total	$ 889,076	$ 839,911	$ 844,501

The Association's concentration of credit risk in various agricultural commodities is shown in the following table. While the amounts represent the Association's maximum potential credit risk as it relates to recorded loan principal, a substantial portion of the Association's lending activities is collateralized and the Association's exposure to credit loss associated with lending activities is reduced accordingly. An estimate of the Association's credit risk exposure is considered in the determination of the allowance for loan losses.

Total loans at December 31, 2004, 2003 and 2002 consisted of the following commodity types:

Commodity Type	December 31, 2004	2003	2002
Poultry	31%	32%	30%
Forestry	16	15	13
Cotton	14	13	14
Livestock	8	9	9
Sugar Cane	7	6	6
Catfish	5	5	7
Rice	4	3	3
Peanuts	2	2	3
Soybeans	2	2	2
Dairy	1	1	1
Other	10	12	12
Total	100%	100%	100%

The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies, but typically includes farmland and income-producing property, such as crops and livestock, as well as receivables. Real estate loans are secured by the first liens on the underlying real property. Federal regulations state that long-term real estate loans are not to exceed 85 percent (97 percent if guaranteed by a government agency) of the property's appraised value. However, a decline in a property's market value subsequent to loan origination or advances, or other actions necessary to protect the financial interest of the Association in the collateral, may result in the loan to value ratios in excess of the regulatory maximum.

Impaired loans are loans for which it is probable that not all principal and interest will be collected according to the contractual terms.

The following table presents information relating to impaired loans.

	December 31, 2004	2003	2002
Nonaccrual loans:			
Current as to principal and interest	$ 752	$ 1,289	$ 1,361
Past due	2,559	2,676	2,322
Total nonaccrual loans	3,311	3,965	3,683
Impaired accrual loans:			
Restructured accrual loans	145	109	154
Accrual loans 90 days or more past due	—	10	105
Total impaired accrual loans	145	119	259
Total impaired loans	$ 3,456	$ 4,084	$ 3,942

There were no material commitments to lend additional funds to debtors whose loans were classified as impaired at December 31, 2004.

Interest income is recognized and cash payments are applied on nonaccrual impaired loans as described in Note 2. The following table presents interest income recognized on impaired loans.

	Year Ended December 31, 2004	2003	2002
Interest income recognized on nonaccrual loans	$ 351	$ 1,078	$ 608
Interest income on impaired accrual loans	425	58	174
Interest income recognized on impaired loans	$ 776	$ 1,136	$ 782

The following table presents information concerning impaired loans as of December 31,

	2004	2003	2002
Impaired loans with related allowance	$ 1,312	$ 1,275	$ 1,407
Impaired loans with no related allowance	2,144	2,809	2,535
Total impaired loans	$ 3,456	$ 4,084	$ 3,942
Allowance on impaired loans	$ 348	$ 276	$ 306

The following table summarizes impaired loan information for the year ended December 31,

	2004	2003	2002
Average impaired loans	$ 5,582	$ 4,208	$ 4,634

Interest income on nonaccrual and accruing restructured loans that would have been recognized under the original terms of the loans for the year ended December 31, 2004 were as follows:

Interest income which would have been recognized under the original loan terms	$ 714
Less: interest income recognized	351
Foregone interest income	$ 363

A summary of the changes in the allowance for loan losses follows:

	Year Ended December 31,		
	2004	2003	2002
Balance at beginning of year	$ 20,630	$ 20,717	$ 19,628
Provision for loan losses	—	1,200	1,200
Nonrecurring provision for loan losses reversal*	(14,809)	—	—
Loans charged off	(815)	(1,449)	(393)
Recoveries	183	162	282
Balance at end of year	$ 5,189	$ 20,630	$ 20,717

* *Represents the amount of provision reversal due to the change in methodology.*

Ratio of net charge-offs during the period to average loans outstanding during the period	0.072%	0.148%	0.014%

As previously discussed in Note 3, the nonrecurring provision for loan losses reversal resulted from the refinement of the Association's allowance for loan losses methodology.

Note 5 — Investment in AgFirst Farm Credit Bank

The Association is required to maintain ownership in the Bank of Class C stock (net of any investment by the Bank in the Association) as determined by the Bank. The Bank may require additional capital contributions to maintain its capital requirements.

The Bank has a reciprocal investment in the Association of $50,589 representing 10,117,847 shares of its nonvoting common stock.

Note 6 — Premises and Equipment

Premises and equipment consisted of the following:

	December 31,		
	2004	2003	2002
Land	$ 1,339	$ 967	$ 983
Buildings and improvements	5,560	5,287	5,235
Furniture and equipment	2,250	2,113	2,101
	9,149	8,367	8,319
Less: accumulated depreciation	5,252	5,087	5,059
Total	$ 3,897	$ 3,280	$ 3,260

Note 7 — Notes Payable to AgFirst Farm Credit Bank

The Association's indebtedness to 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 and the terms of the revolving lines of credit are governed by a general financing agreement. Interest rates on both variable and fixed rate notes payable are generally established loan-by-loan based on the Bank's marginal cost of funds, capital position, operating costs and return objectives. The interest rate is periodically adjusted by the Bank based upon agreement between the Bank and Association. The weighted average interest rates on the variable rate notes were 3.39 percent for LIBOR-based loans, 3.17 percent for Prime-based loans, and the weighted average remaining maturities were 2.5 years and 2.4 years, respectively, at December 31, 2004. The weighted average interest rate on the fixed rate and adjustable rate mortgage (ARM) notes payable which are match funded by the Bank was 3.58 percent and the weighted average remaining maturity was 3.6 years at December 31, 2004. The weighted average interest rate on all interest-bearing notes payable was 3.44 percent and the weighted average remaining maturity was 3.2 years at December 31, 2004.

Variable rate and fixed rate notes payable represent approximately 31.79 percent and 68.21 percent, respectively, of total notes payable at December 31, 2004.

The Bank, consistent with FCA regulations, has established limitations on the Association's ability to borrow funds based on specified factors or formulas relating primarily to credit quality and financial condition. At December 31, 2004, the Association's notes payable were within the specified limitations.

Note 8 — Members' Equity

A description of the Association's capitalization requirements, protection mechanisms, regulatory capitalization requirements and restrictions, and equities are provided below.

A. **Protected Borrower Equity**

Protection of certain borrower equity is provided under the Farm Credit Act which requires the Association, when retiring protected borrower equity, to retire such equity at par or stated value regardless of its book value. Protected borrower equity includes capital stock, participation certificates and allocated equities which were outstanding as of January 6, 1988, or were issued or allocated prior to October 6, 1988. If an Association is unable to retire protected borrower equity at par value or stated value, amounts required to retire this equity would be obtained from the Insurance Fund.

B. **Capital Stock and Participation Certificates**

In accordance with the Farm Credit Act and the Association's capitalization bylaws, each borrower is required to invest in Class C stock for agricultural loans, or participation certificates in the case of rural home and farm related business loans, as a condition of borrowing. The initial borrower investment, through either purchase or transfer, must be in an amount equal to 2 percent of the loan or $5 thousand, whichever is less. The Board of Directors may increase the amount of investment if necessary to meet the Association's capital needs. Loans designated for sale or sold into the Secondary Market on or after April 16, 1996 will have no voting stock or participation certificate purchase requirement if sold within 180 days following the date of designation.

The borrower acquires ownership of the capital stock or participation certificates at the time the loan is made, but usually does not make a cash investment. The aggregate par value is generally added to the principal amount of the related loan obligation. The Association retains a first lien on the stock or participation certificates owned by borrowers. Retirement of such equities will generally be at the lower of par or book value, and repayment of a loan does not automatically result in retirement of the corresponding stock or participation certificates.

C. **Regulatory Capitalization Requirements and Restrictions**

FCA's capital adequacy regulations require the Association to achieve permanent capital of seven percent of risk-adjusted assets and off-balance-sheet commitments. Failure to meet the seven percent capital requirement can initiate certain mandatory and possibly additional discretionary actions by FCA that, if undertaken, could have a direct material effect on the Association's consolidated financial statements. The Association is prohibited from reducing permanent capital by retiring stock or making certain other distributions to shareholders unless prescribed capital standards are met. FCA regulations also require that additional minimum standards for capital be achieved. These standards require all System institutions to achieve and maintain ratios as defined by FCA regulations. These required ratios are total surplus as a percentage of risk-adjusted assets of seven percent and of core surplus as a percentage of risk-adjusted assets of three and one-half percent. The Association's permanent capital, total surplus and core surplus ratios at December 31, 2004 were 13.59 percent, 12.21 percent and 9.38 percent, respectively.

An FCA regulation empowers it to direct a transfer of funds or equities by one or more System institutions to another System institution under specified circumstances. The Association has not been called upon to initiate any transfers and is not aware of any proposed action under this regulation.

D. **Description of Equities**

The Association is authorized to issue or have outstanding Class A Nonvoting Common Stock, Class C Voting Common Stock, and Class D Preferred Stock, and nonvoting Participation Certificates. All shares of stock and participation certificates have a par or face value of five dollars ($5.00) per share.

The Association had the following shares outstanding at December 31, 2004:

		Shares Outstanding	
Class	**Protected**	**Number**	**Aggregate Par Value**
A Common/Nonvoting	Yes	28,382	$ 142
A Common/Nonvoting	No	10,799	54
C Common/Voting	No	2,498,316	12,491
Common Issued to Bank/Nonvoting	No	10,117,847	50,589
C Participation Certificates/Nonvoting	No	45,106	226
Total Capital Stock and Participation Certificates		12,700,450	$ 63,502

Protected common stock is retired at par or face value in the ordinary course of business. At-risk common stock and participation certificates are retired at the sole discretion of the Board at book value not to exceed par or face amounts, provided the minimum capital adequacy standards established by the Board are met.

Surplus Accounts

The Association maintains an unallocated surplus account and an allocated surplus account. The minimum aggregate amounts of these two accounts shall be prescribed by the Farm Credit Act and the FCA regulations. The allocated surplus account consists of earnings held therein and allocated to borrowers on a patronage basis.

In the event of a net loss for any fiscal year, such loss shall be absorbed by, first, charges to the unallocated surplus account; second, impairment of paid-in surplus; and third, impairment of the allocated surplus account on the basis of latest allocations first.

The Association shall have a first lien on all surplus account allocations owned by any borrower, and all distributions thereof, as additional collateral for such borrower's indebtedness to the Association. When the debt of a borrower is in default or is in the process of final liquidation, the Association may, upon notice to the borrower, order any and all surplus account allocations owned by such borrower to be applied against the indebtedness. Any such retirement and application against indebtedness of surplus account allocations shall be before similar retirement and application of stock or participation certificates owned by the borrower.

When all of the stock and participation certificates of the Association owned by a borrower are retired or otherwise disposed of, any surplus account allocations owned by such borrower may also be retired upon request by the borrower and subject to the approval of the Board, and the proceeds paid to the borrower. Alternatively, if the Board so directs, upon notice to the borrower such surplus account allocations may be applied against any of the borrower's indebtedness to the Association.

Subject to the Farm Credit Act and FCA regulations, allocated surplus may be distributed in cash, oldest allocations first. The cash proceeds may be applied against the indebtedness of the borrower to the Association. In no event shall such distributions reduce the surplus account below the minimum amount prescribed by the Farm Credit Act and FCA regulations. Distributions of less than the full amount of all allocations issued as of the same date shall be on a pro rata basis.

At December 31, 2004, allocated members' equity consisted of $36,428 of qualified surplus, $9,084 of nonqualified allocated surplus and $12,551 of nonqualified retained surplus.

Patronage Distributions

Prior to the beginning of any fiscal year, the Board, by adoption of a resolution, may obligate the Association to distribute to borrowers on a patronage basis all or any portion of available net earnings for such fiscal year or for that and subsequent fiscal years. Patronage distributions are based on the proportion of the borrower's interest to the amount of interest earned by the Association on its total loans unless another proportionate patronage basis is approved by the Board.

If the Association meets its capital adequacy standards after making the patronage distributions, the patronage distributions may be in cash, authorized stock of the Association, allocations of earnings retained in an allocated members' equity account, or any one or more of such forms of distribution. Patronage distributions of the Association's earnings may be paid on either a qualified or nonqualified basis, or a combination of both, as determined by the Board. A minimum of 20 percent of the total qualified patronage distribution to any borrower for any fiscal year shall always be paid in cash.

Transfer

Stock and participation certificates may be transferred only to persons eligible to purchase and hold such stock or participation certificates.

Impairment

Any losses which result in an impairment of the Association's capital shall be borne ratably by, first, each share of Class A Nonvoting Common Stock and Class C Voting Common Stock and unit of participation certificates outstanding; and, second, by each share of Class D Preferred Stock outstanding, if any, all as of the date such losses are determined.

Liquidation

In the event of liquidation or dissolution of the Association, any assets of the Association remaining after payment or retirement of all liabilities shall be distributed to the holders of stock and participation certificates in the following order of priority:

1. To the holders of Class D Preferred Stock, if any, pro rata in proportion to the number of shares then issued and outstanding until an amount equal to the aggregate par value of all such shares has been distributed to all such holders.

2. To the holders of Class A Nonvoting Common Stock and Class C Voting Common Stock and participation certificates, pro rata in proportion to the number of shares or units of each such class of stock or participation certificates then issued and outstanding until an amount equal to the aggregate par value of all such shares or units has been distributed to all such holders.

3. Any remaining assets of the Association after such distributions shall be distributed to the holders of Class A Nonvoting Common Stock and Class C Voting Common Stock, and participation certificates, pro rata in proportion to the number of shares or units then outstanding.

Note 9 — Income Taxes

The provision (benefit) for income taxes follows:

	Year Ended December 31, 2004	2003	2002
Current:			
Federal	$ 298	$ 574	$ 737
State	(18)	70	51
	280	644	788
Deferred:			
Federal	474	5	162
	474	5	162
Total provision (benefit) for income taxes	$ 754	$ 649	$ 950

The provision (benefit) for income tax differs from the amount of income tax determined by applying the applicable U.S. statutory federal income tax rate to pretax income as follows:

	December 31, 2004	2003	2002
Federal tax at statutory rate	$ 10,560	$ 4,553	$ 4,788
State tax, net	(12)	46	34
Patronage distributions	(2,362)	(1,841)	(2,515)
Tax-exempt FLCA earnings	(4,397)	(2,163)	(1,539)
Deferred tax asset adjustment	—	—	84
Allowance for loan loss reversal	(3,352)	—	—
Other	317	54	98
Provision (benefit) for income taxes	$ 754	$ 649	$ 950

Deferred tax assets and liabilities result from the following at:

	December 31, 2004	2003	2002
Allowance for loan losses	$ 114	$ 578	$ 577
Nonaccrual loan interest	32	32	32
Postretirement benefits other than pensions	472	442	444
Gross deferred tax assets	618	1,052	1,053
Future Bank equity redemption	(432)	(413)	(410)
Loan fees	(1)	(1)	—
Pensions	(377)	(355)	(355)
Gross deferred tax liability	(810)	(769)	(765)
Net deferred tax asset (liability)	$ (192)	$ 283	$ 288

At December 31, 2004, deferred income taxes have not been provided by the Association on approximately $55.7 million of patronage refunds received from the Bank prior to January 1, 1993. Such refunds, distributed in the form of stock, are subject to tax only upon conversion to cash. The tax liability related to future conversions is not expected to be material.

Note 10 — Employee Benefit Plans

The Association's employees participate in a defined benefit retirement plan. This plan is noncontributory and covers substantially all employees of the Association. Benefits are based on salary and years of service. The measurement date for the plan is September 30.

The following table sets forth the obligations and funded status of the retirement plan:

	As of December 31, 2004	2003	2002
Change in projected benefit obligation			
Benefit obligation at beginning of year	$ 36,387	$ 31,162	$ 25,946
Service cost	1,155	978	803
Interest cost	2,232	2,064	1,898
Actuarial loss (gain)	339	3,502	3,748
Benefits paid	(1,376)	(1,319)	(1,233)
Benefit obligation at end of year	$ 38,737	$ 36,387	$ 31,162
Change in plan assets			
Fair value of plan assets at beginning of year	$ 30,056	$ 26,991	$ 30,729
Actual return on plan assets	3,014	3,576	(2,220)
Employer contributions	1,012	1,021	—
Benefits paid	(1,376)	(1,318)	(1,234)
Expenses	(303)	(214)	(284)
Fair value of plan assets at end of year	$ 32,403	$ 30,056	$ 26,991
Funded status (benefit obligation less FV of plan assets)	$ (6,334)	$ (6,331)	$ (4,171)
Unrecognized net actuarial loss (gain)	12,749	13,664	12,226
Unrecognized prior service cost	1,192	1,457	1,721
Unrecognized net (asset) or obligation	(1,026)	(1,364)	(1,702)
Net amount recognized	$ 6,581	$ 7,426	$ 8,074
Prepaid benefit costs	$ 6,581	$ 7,426	$ 8,074
Accumulated benefit obligation for the defined benefit plan at December 31			
Projected benefit obligation	$ 38,737	$ 36,387	$ 31,162
Accumulated benefit obligation	32,126	28,776	24,872
Fair value of plan assets	32,403	30,056	26,991
Components of net periodic benefit/(income) cost			
Service cost	$ 1,155	$ 978	$ 803
Interest cost	2,232	2,064	1,898
Expected return on plan assets	(2,342)	(2,101)	(2,697)
Amortization of net (gain) loss	(338)	(338)	(338)
Amortization of prior service cost	264	264	264
Recognized net actuarial (gain)/loss	885	803	20
Net periodic benefit (income) cost	$ 1,856	$ 1,670	$ (50)
Assumptions:			
Weighted-average assumptions used to determine benefit obligations at December 31			
Discount rate	6.00%	6.25%	6.75%
Rate of compensation increase	5.00%	5.00%	5.00%
Weighted-average assumptions used to determine net periodic benefit cost for years ended December 31			
Discount rate	6.25%	6.75%	7.50%
Expected long-term return on plan assets	8.00%	8.00%	8.00%
Rate of compensation increase	5.00%	5.00%	5.00%

In 2004, 2003 and 2002 the Association used a long-term rate of return of 8 percent. The Association utilizes a weighted average of expected returns for each major class based on the asset allocation percentages for the plan assets. Prevailing market conditions, historical trends and peer comparisons were also utilized in assigning the 8 percent expected rate of return.

PLAN ASSETS	2004	2003	2002
Asset Category			
Equity securities	64%	66%	55%
Debt securities	31%	32%	41%
Other	5%	2%	4%
	100%	100%	100%

The primary investment objective of the retirement plan is to invest pension fund assets and contributions to assure that there will be no erosion of funds and the purchasing power thereof. The Association recognizes that risk, volatility and the possibility of loss in purchasing power are present in all type of investment vehicles. The Association has taken a conservative approach to achieve these goals by limiting equity investments to 70 percent of the total portfolio and limiting debt securities to 60 percent of the total portfolio.

Target allocation for asset categories for 2005 are as follows:

Asset Category	
Equity securities	60-70%
Debt securities	30-40%
	100%

Expected Benefit Payments: The total employer contribution expected during 2005 is $830. Estimated future benefit payments are as follows:

Fiscal 2005	$ 1,506
Fiscal 2006	$ 1,555
Fiscal 2007	$ 1,543
Fiscal 2008	$ 1,631
Fiscal 2009	$ 1,813
Fiscal 2010 – 2014	$ 12,961

The Association also participates in a districtwide Thrift Plan. The Thrift Plan requires the Association to match 50 percent of employee optional contributions up to a maximum employee contribution of 6 percent of total compensation.

The District sponsors a plan providing certain benefits (primarily health care) to its retirees. Certain Association charges related to this plan are an allocation of District charges based on the Association's proportional share of the plan liability.

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (Medicare Act) was signed into law. This act introduces a prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. In May 2004, the FASB issued FASB Staff Position (FSP) 106-2, Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" (the Act). This Staff Position provides guidance on the accounting for the effects of the Act for employers that sponsor postretirement health care plans that provide prescription drug benefits. The District sponsored plan adopted FSP 106-2 effective July 1, 2004 (measured as of March 31, 2004), and, accordingly, the benefit obligation valuation as of December 31, 2004 reflects the impact of the Medicare Act. For Medicare-eligible participants receiving actuarially equivalent drug benefits, the expected per capita claims cost are estimated to be reduced by 12 percent beginning in 2006 due to a government reimbursement of a portion of prescription drug benefits. Subsidies under the Medicare Act will reduce the current period measurements of benefits expected to be provided in future periods. Due to the status of the plan and the assumptions used in the remeasurement upon adoption of FSP 106-2, there was no effect on expense for 2004.

The following is a table of retirement and postretirement benefits expenses (credits):

	2004	2003	2002
Pension	$1,856	$1,670	$ (50)
Thrift/deferred compensation	259	241	236
Other postretirement benefits	1,163	963	563
Total	$3,278	$2,874	$ 749

Note 11 — Intra-System Financial Assistance

The Farm Credit System Financial Assistance Corporation (Financial Assistance Corporation) was established in 1988 primarily to provide capital to institutions of the System experiencing financial difficulty. Such assistance was funded through the Financial Assistance Corporation's issuance of $1.261 billion of 15-year U.S. Treasury-guaranteed debt. The interest rates on these issuances range from 8.80 percent to 9.45 percent. The repayment of this debt and related interest is the responsibility of System banks. At December 31, 2004, $325 million of Financial Assistance Corporation debt remains outstanding and will mature in June 2005. All other debt has either matured or was called and redeemed.

Each System bank may be required to pay premiums into the Insurance Fund based on its annual average loan principal outstanding. The Bank, in turn, may also assess the Association for insurance premiums based on the average principal outstanding of accrual and nonaccrual loans of the Association for each year. At December 31, 2004, the assets in the Insurance Fund aggregated $2.164 billion. However, due to the authorized uses of the Insurance Fund, there is no assurance that Fund assets will be available or sufficient to ensure the payment of principal of, or interest on, insured debt securities in the event of a default by any System bank having primary liability thereon.

Note 12 — Related Party Transactions

In the ordinary course of business, the Association enters into loan transactions with officers and directors of the Association, their immediate families and other organizations with which such persons may be associated. Such loans are subject to special approval requirements contained in the FCA regulations and are made on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated borrowers.

Total loans to such persons at December 31, 2004 amounted to $14,312. During 2004, $18,175 of new loans were made and repayments totaled $15,279. In the opinion of management, none of these loans outstanding at December 31, 2004 involved more than a normal risk of collectibility.

Note 13 — Commitments and Contingencies

The Association has various commitments outstanding and contingent liabilities.

The Association may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of its borrowers and to manage their exposure to interest-rate risk. These financial instruments include commitments to extend credit and/or commercial letters of credit. The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the financial statements. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. Commercial letters of credit are agreements to pay a beneficiary under conditions specified in the letter of credit. Commitments and letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. At December 31, 2004, $240,713 of commitments to extend credit and $4,188 of standby and commercial letters of credit were outstanding.

Since many of these commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. However, these credit-related financial instruments have off-balance-sheet credit risk because their amounts are not reflected on the Balance Sheet until funded or drawn upon. The credit risk associated with issuing commitments and letters of credit is substantially the same as that involved in extending loans to borrowers and management applies the same credit policies to these commitments. Upon fully funding a commitment, the credit risk amounts are equal to the contract amounts, assuming that borrowers fail completely to meet their obligations and the collateral or other security is of no value. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower.

The Association also participates in standby letters of credit to satisfy the financing needs of its borrowers. These letters of credit are irrevocable agreements to guarantee payments of specified financial obligations. Outstanding standby letters of credit have expiration dates ranging from June 30, 2005 to February 26, 2008.

Note 14 — Disclosures About Fair Value of Financial Instruments

The following table presents the carrying amounts and fair values of the Association's financial instruments at December 31, 2004, 2003 and 2002. The fair value of a financial instrument is generally defined as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Quoted market prices are generally not available for certain System financial instruments, as described 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.

The estimated fair values of the Association's financial instruments are as follows:

	December 31, 2004		December 31, 2003	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash	$ 10,375	$ 10,375	$ 10,372	$ 10,372
Loans	$ 889,076	$ 898,482	$ 839,911	$ 849,656
Allowance for loan losses	5,189	—	20,630	—
Loans, net	$ 883,887	$ 898,482	$ 819,281	$ 849,656
Financial liabilities:				
Notes payable to AgFirst Farm Credit Bank	$ 759,497	$ 758,074	$ 712,060	$ 712,822

	December 31, 2002	
	Carrying Amount	Estimated Fair Value
Financial assets:		
Cash	$ 11,455	$ 11,455
Loans	$ 844,501	$ 861,790
Allowance for loan losses	20,717	—
Loans, net	$ 823,784	$ 861,790
Financial liabilities:		
Notes payable to AgFirst Farm Credit Bank	$ 724,781	$ 733,983

A description of the methods and assumptions used to estimate the fair value of each class of the Association's financial instruments for which it is practicable to estimate that value follows:

A. **Cash:** The carrying value is a reasonable estimate of fair value.

B. **Loans:** Because no active market exists for the Association's loans, fair value is estimated by discounting the expected future cash flows using the Association's current interest rates at which similar loans would be made to borrowers with similar credit risk. As the discount rates are based on the Bank's loan rates, as well as management estimates, management has no basis to determine whether the fair values presented would be indicative of the value negotiated in an actual sale.

   For purposes of determining fair value of accruing loans, the loan portfolio is segregated into pools of loans with homogeneous characteristics based upon repricing and credit risk. Expected future cash flows and interest rates reflecting appropriate credit risk are separately determined for each individual pool.

   Fair value of loans in a nonaccrual status is estimated to be the carrying amount less specific reserves.

   The carrying value of accrued interest approximates its fair value.

C. **Investment in AgFirst Farm Credit Bank and Other Farm Credit Institutions:** Estimating the fair value of the Association's investment in the Bank is not practicable because the stock is not traded. As described in Note 5, the net investment is a requirement of borrowing from the Bank and is carried at cost plus allocated equities in the accompanying balance sheet. The Association owns 6.50 percent of the issued stock of the Bank as of December 31, 2004 net of any reciprocal investment. As of that date, the Bank's assets totaled $16.9 billion and shareholders' equity totaled $1,024 million. The Bank's earnings were $180 million during 2004.

   In addition, the Association has an investment of $22 related to other Farm Credit institutions.

D. **Notes Payable to AgFirst Farm Credit Bank:** The notes payable are segregated into pricing pools according to the types and terms of the loans (or other assets) which they fund. Fair value of the notes payable is estimated by discounting the anticipated cash flows of each pricing pool using the current rate that would be charged for additional borrowings. For purposes of this estimate it is assumed the cash flow on the notes is equal to the principal payments on the Association's loan receivables plus accrued interest on the notes payable. This assumption implies that earnings on the Association's interest margin are used to fund operating expenses and capital expenditures.

E. **Commitments to Extend Credit and Standby Letters of Credit:** The estimated market value of off-balance-sheet commitments is minimal since the committed rate approximates current rates offered for commitments with similar rate and maturity characteristics and since the related credit risk is not significant.

Note 15 — Quarterly Financial Information (Unaudited)

Quarterly results of operations for the years ended December 31, 2004, 2003 and 2002 follow:

	2004				
	First	**Second**	**Third**	**Fourth**	**Total**
Net interest income	$ 5,765	$ 6,220	$ 6,969	$ 7,021	$25,975
Provision for (reversal of) loan losses	—	—	—	(14,809)	(14,809)
Noninterest income (expense), net	(3,104)	(3,033)	(2,362)	(1,979)	(10,478)
Net income (loss)	$ 2,661	$ 3,187	$ 4,607	$19,851	$30,306

	2003				
	First	**Second**	**Third**	**Fourth**	**Total**
Net interest income	$ 5,734	$ 6,302	$ 7,509	$ 6,340	$25,885
Provision for (reversal of) loan losses	300	300	300	300	1,200
Noninterest income (expense), net	(2,803)	(2,618)	(2,654)	(3,869)	(11,944)
Net income (loss)	$ 2,631	$ 3,384	$ 4,555	$ 2,171	$12,741

	2002				
	First	**Second**	**Third**	**Fourth**	**Total**
Net interest income	$ 5,046	$ 5,698	$ 6,628	$ 6,467	$23,839
Provision for (reversal of) loan losses	300	300	300	300	1,200
Noninterest income (expense), net	(2,269)	(1,908)	(2,090)	(3,239)	(9,506)
Net income (loss)	$ 2,477	$ 3,490	$ 4,238	$ 2,928	$13,133