

2002 ANNUAL REPORT

FARM CREDIT OF NORTHWEST FLORIDA, ACA

2002 ANNUAL REPORT

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Management

James R. Alberts.....	Chief Executive Officer
Bruce C. Harrison	Chief Financial Officer
Wesley O. Pope.....	Chief Appraiser
Wade Hayslip.....	Central/Western Executive Manager
Maitland Remington	Eastern Regional Lending Manager
Jay Baker	Western Regional Lending Manager
Jim Dean.....	Central Regional Lending Manager
Deandrea Barber	Loan Operations Manager

Board of Directors

James G. Ditty.....	Chairman
Richard Terry	Vice Chairman
Melvin T. Adams	Director
Bobby A. Boutwell	Director
Ben C. Gilbert	Director
Copeland Griswold	Director
Kenneth McCroan.....	Director
Ronald W. Thompson.....	Director
George T. VanPelt	Director
T. B. Walker.....	Director

Message from the President

2002 — A Year of Challenge, Difficulty and Great Progress

America has continued to experience amazing circumstances such as terrorism concerns, turmoil in the financial markets, threats of war and traumatic difficulties in some sectors of the economy. We also were subjected to unique internal challenges, such as accelerating operating expenses.

These issues have strengthened the resolve of your management team to focus on excellence and provide a standard of responsiveness to our patrons, which is substantially in excess of their expectations.

Income before income taxes increased 15.76 percent or \$837 thousand from that in the year 2001. This is especially impressive considering the fact that operating expenses were over 25 percent higher than the previous year. Year-end loan volume exceeded 2001 by 6.69 percent or \$16 million.

Loan volume increases continue to be the result of your Association team attracting new and well-diversified patrons to the portfolio. A portion of the growth is the result of referrals from existing members; thereby attesting to their satisfaction with Association responsiveness, flexibility and service. High-risk assets as a percentage of total assets increased from .99 percent in 2001 to 1.33 percent in 2002 primarily due to one loan relationship.

Critical capital ratios have strengthened since year-end 2001 as evidenced by information presented below. We are diligently managing capital to ensure that the critical issues of growth, patronage dividends, distribution of allocated surplus, profitability and regulatory policies are all synergistically considered. Of course, our primary interest is the safety and soundness of this organization and ensuring that it is adequately capitalized to protect and secure shareholder ownership.

	As of 12/31/02	As of 12/31/01	Regulatory Required
Permanent Capital	12.53 %	11.74 %	7.00 %
Core Surplus	9.47 %	6.98 %	3.50 %
Total Surplus	11.99 %	11.17 %	7.00 %

These enhanced capital ratios along with a reserve for loan losses of 2.27 percent of year-end loans should adequately provide for financial stability and accomplish the additional objective of ensuring the safety, as well as protection, of shareholder owned surplus.

The benefits to borrowers of ownership are especially apparent when one examines the remarkable record of patronage and allocated surplus distributions. The record of continued dividends remains unabated and is one of the primary objectives of this Association. Estimated patronage for 2003 based on 2002 earnings is \$6.38 million with over \$1.68 million, or 30 percent of pre-tax GAAP earnings to be paid in cash. This impressive distribution, based upon 2002 earnings, will represent approximately 25 percent of eligible taxable interest earned by the Association, in other words, about 25 cents of every dollar of interest accrued on individual loans will have been returned to our patrons in the form of a patronage distribution.

An examination of the comprehensive chart below demonstrates that \$3.675 million in cash was distributed to patrons/borrowers during the year 2002. Subject to prudence and allowing accommodation for additional growth, the Association maintains the objective of returning shareholder surplus on a regularly scheduled basis contingent upon the maintenance of a high level of capitalization.

Distribution Date	Distribution Description	Amount of Distribution
January 2002	Allocated Surplus 1995 (25%)	\$ 765,447
March 2002	Patronage (Allocated Surplus cash portion) 2001 (30%)	\$1,615,268
May 2002	Allocated Surplus 1995 (25%)	\$ 748,426
December 2002	Allocated Surplus 1996 (25%)	\$ 546,316

We are committed to continuing exemplary performance. This includes positive profitability and a reasonable level of growth accommodating eligible borrowers.

The traumatic circumstances described at the beginning of this message have not adversely affected economic conditions in our territory; however, we remain diligent and will conduct operations in such a manner that unnecessary risk will not be introduced into our asset base.

The Future

As this message is being written, all of the negative events described in the opening paragraph continue in this country. We affirm the need to remain diligent and cautious; it is recognized that this organization is in the service business and we must continue to execute performance that demonstrates the ability to serve the needs of eligible borrowers superior to any other organization. Our patrons and potential patrons will receive flexible, custom designed accommodations, along with individualized interest and attention.

We are continuing to upgrade technology to enable the most prompt and effective method of serving the lending needs of clients. We are undertaking a modest and cost effective expansion to the Administrative Offices necessitated by growth. Our personnel are receiving "state of the art" training and educational initiatives continue to be a high priority.

Our 2003 more prominent goals include:

1. An exemplary level of human resource training/development and recruitment,
2. Focused and aggressive marketing,
3. Innovative management of costs and absolute minimization of unnecessary overhead,
4. Enhancement of our outreach to young, beginning, and small farmers.

Association 2002 performance did exceed our expectations; however, please recognize that economic times remain uncertain and we must react accordingly. We will absolutely strive for excellence and serve the needs of our patrons in a manner that protects capital.

We believe our mission statement demonstrates this focus:

Mission Statement

We will take a hands-on team approach with original and inspired initiatives to assist Customers/Partners.

We will surpass expectations of the shareholders and Prospective shareholders with empathy, responsiveness and flexibility.

Superiority is the standard for our individual and Organizational performance.

We anticipate an exceptional future and continue to welcome change. Maintaining exemplary standards for service and financial performance remain our primary objectives.



James R. Alberts
President

February 19, 2003

Report of Management

The accompanying consolidated financial statements and related financial information appearing throughout this annual report have been prepared by management of Farm Credit of Northwest Florida, 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 accountants, whose report appears elsewhere in this annual report. The Association is also subject to examination by the Farm Credit Administration.

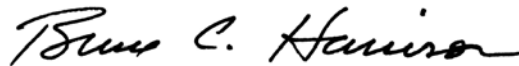
The consolidated financial statements, in the opinion of management, fairly present the financial condition of the Association. The undersigned certify that the 2002 Annual Report has been prepared in accordance with all applicable statutory or regulatory requirements and that the information contained herein is true, accurate, and complete to the best of our knowledge and belief.



James G. Ditty
Chairman of the Board



James R. Alberts
Chief Executive Officer



Bruce C. Harrison
Chief Financial Officer

February 19, 2003

Consolidated Five - Year Summary of Selected Financial Data

(UNAUDITED)

<i>(dollars in thousands)</i>	2002	2001	December 31, 2000	1999	1998
Balance Sheet Data					
Cash	\$ 47	\$ 76	\$ 1,423	\$ 11	\$ 2
Loans	256,055	239,988	201,661	194,506	171,065
Less: allowance for loan losses	5,822	5,859	5,833	5,818	5,692
Net loans	250,233	234,129	195,828	188,688	165,373
Investment in AgFirst Farm Credit Bank	4,259	5,030	4,897	4,897	4,640
Other property owned	—	99	1,458	—	—
Other assets	5,484	6,438	6,390	5,703	5,756
Total assets	\$ 260,023	\$ 245,772	\$ 209,996	\$ 199,299	\$ 175,771
Notes payable to AgFirst Farm Credit Bank*	\$ 221,019	\$ 208,171	\$ 174,613	\$ 165,931	\$ 143,497
Accrued interest payable and other liabilities with maturities of less than one year	6,126	5,142	4,697	4,112	3,670
Total liabilities	227,145	213,313	179,310	170,043	147,167
Protected borrower equity	317	360	444	559	730
Capital stock and participation certificates	1,300	1,298	1,116	1,214	1,188
Retained earnings					
Allocated	21,288	18,584	17,478	16,608	16,283
Unallocated	11,866	12,217	11,648	10,875	10,403
Accumulated other comprehensive income (loss)	(1,893)	—	—	—	—
Total members' equity	32,878	32,459	30,686	29,256	28,604
Total liabilities and members' equity	\$ 260,023	\$ 245,772	\$ 209,996	\$ 199,299	\$ 175,771
Statement of Income Data					
Net interest income	\$ 7,314	\$ 6,765	\$ 6,544	\$ 6,303	\$ 6,654
Provision for (reversal of) loan losses	—	225	250	185	423
Noninterest income (expense), net	(1,287)	(418)	(1,439)	(1,251)	(1,312)
Net income	\$ 6,027	\$ 6,122	\$ 4,855	\$ 4,867	\$ 4,919
Key Financial Ratios					
Rate of return on average:					
Total assets	2.38%	2.69%	2.45%	2.59%	2.91%
Total members' equity	17.44%	18.87%	15.78%	16.22%	17.56%
Net interest income as a percentage of average earning assets	2.96%	3.08%	3.43%	3.48%	4.09%
Net chargeoffs (recoveries) to average loans	0.01%	0.09%	0.12%	0.03%	0.21%
Total members' equity to total assets	12.64%	13.21%	14.61%	14.68%	16.27%
Debt to members' equity (:1)	6.91	6.57	5.84	5.81	5.14
Allowance for loan losses to loans	2.27%	2.44%	2.89%	2.99%	3.33%
Permanent capital ratio	12.53%	11.74%	13.58%	13.53%	14.48%
Total surplus ratio	11.99%	11.17%	12.98%	13.18%	13.73%
Core surplus ratio	9.47%	6.98%	7.98%	8.29%	9.61%
Net Income Distribution					
Estimated patronage refunds:					
Cash dividend	\$ 1,685	\$ 1,615	\$ 1,218	\$ 1,302	\$ 1,129
Qualified allocated surplus	—	—	2,842	3,037	2,634
Nonqualified allocated surplus	2,246	2,692	—	—	—
Nonqualified retained surplus	2,447	1,077	—	—	—

* General financing agreement is renewable on two-year cycles. The next renewal date is December 31, 2004.

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

(dollars in thousands, except as noted)

The following commentary reviews the financial condition and results of operations of Farm Credit of Northwest Florida for the years ended December 31, 2002 and December 31, 2001. 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's loan portfolio continues to be very well diversified from a risk perspective. Property values remain stable with a continued moderate increase in market values.

While weather conditions remain unusual, only a very small portion of the Association's loans have been adversely affected.

The Association continues to attract new members as well as retaining our existing membership. The exemplary service that our members have come to expect will continue to be of the utmost priority.

Our primary competition continues from locally owned/controlled commercial banks. However, regional banking institutions are very competitive for larger agri-business credit. Continued efforts are being made to enhance service, increase public knowledge of our products and streamline credit delivery. Looking ahead to 2003, we expect eligible borrowers to remain debt conscious and maintain a sound capital base. Many members have continued to reduce debt, which in turn prepares them to maintain viability even when conditions are not favorable.

During 2002, the Association targeted certain segments of our business with hopes of increasing market share. Continued efforts are being made to expand our membership, 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 and long-term real estate mortgage loans. The geographic distribution of the accrual loans is as follows:

Branch	12/31/02	12/31/01
Milton	19.73%	17.00%
Monticello	18.16	16.49
Madison	9.02	8.19
Commercial Credits	31.90	39.25
Marianna	20.64	19.07
Administrative	.55	—
	<u>100.00%</u>	<u>100.00%</u>

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

Loan Type	12/31/02	12/31/01
Long-term farm mortgage	11.18%	9.67%
Production and intermediate-term	81.88	80.45
Rural home	6.92	7.11
Farm-related business	3.56	5.89
Nonaccrual	1.22	.72
Sales contracts/purchase money mortgages	.33	.36
Participations purchased	2.82	—
Less: participations sold	(7.91)	(4.20)
	<u>100.00%</u>	<u>100.00%</u>

Predominant commodities in the portfolio are forestry, livestock, peanuts, other row crops and rural homes that constitute over 70 percent of the entire portfolio. Please refer to Note 3 in the Notes to the Consolidated Financial Statements section of this annual report for additional information concerning the loan types and loan portfolio.

The Association's gross loan volume as of December 31, 2002, was \$256,055, an increase of \$16,067 or 6.69 percent as compared to \$239,988 at December 31, 2001. Net loan volume on December 31, 2002, was \$250,233, an increase of \$16,104 or 6.88 percent as compared to \$234,129 at December 31, 2001. Net loans accounted for 96.23 percent of total assets on December 31, 2002 as compared to 95.26 percent of total assets at December 31, 2001.

There is an inherent risk in the extension of any type of credit. Association management maintains an allowance for loan losses in an amount sufficient to absorb possible losses in the loan portfolio based on current and expected future conditions. The allowance for loan losses at December 31, 2002 was \$5,822 and was considered by management to be adequate to cover possible losses.

The Association's loan portfolio is divided into performing and high-risk categories. The high-risk assets, including accrued interest, are detailed below:

	12/31/02	12/31/01
High-risk Assets		
Nonaccrual loans	\$ 3,133	\$ 1,725
Restructured loans	312	545
Accruing loans 90 days past due	22	67
Total high-risk loans	<u>3,467</u>	<u>2,337</u>
Other property owned	—	99
Total high-risk assets	<u>\$ 3,467</u>	<u>\$ 2,436</u>
Ratios		
Nonaccrual loans to total loans	1.22%	.72%
High-risk assets to total assets	1.33%	.99%

Nonaccrual loans increased \$1,408, or 81.62 percent in 2002. Management is not aware of any other significant potential credit risks within the loan portfolio that could adversely impact the performance of the loan portfolio in the near future.

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.

RESULTS OF OPERATIONS

	December 2002	December 2001	Variance	% Variance
Interest Income	\$16,369	\$17,988	\$(1,619)	(9.00)%
Reinstatement Income	65	11	54	491.00
Total Interest Income	16,434	17,999	(1,565)	(8.69)
Interest Expense	9,120	11,234	(2,114)	(18.82)
Net Interest Income	7,314	6,765	549	8.12
Final Net Income	6,027	6,122	(95)	(1.55)

Net income for the year ended December 31, 2002, totaled \$6,027, a decrease of \$95 or 1.55 percent, as compared to \$6,122 for the same period of 2001. Interest income for the year ended December 31, 2002, was \$16,434 a decrease of \$1,565 or 8.69 percent as compared to \$17,999 for the same period of 2001. Major components of the changes in net income for the past two years are outlined in the following table.

Changes in Net Income:

	2002-2001	2001-2000
Net income (prior year)	\$ 6,122	\$ 4,855
Increase (decrease) in net income due to:		
Interest income	(1,565)	(113)
Interest expense	2,114	334
Net interest income	549	221
Provision for loan losses	225	25
Noninterest income	787	201
Noninterest expense	(724)	(365)
Benefit (provision) for income taxes	(932)	1,185
Total changes in income	<u>(95)</u>	<u>1,267</u>
Net income	<u>\$ 6,027</u>	<u>\$ 6,122</u>

Net interest income was up by \$549 or 8.12 percent in 2002 compared to 2001. The primary reason for this increase was an increase in loan volume. Interest income on nonaccrual loans for the twelve months ended December 31, 2002, totaled \$65, an increase of \$54, compared to \$11 at the previous year-end. 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
12/31/02 - 12/31/01				
Interest income	\$ 1,051	\$ (2,670)	\$ 54	\$ (1,565)
Interest expense	591	(2,705)	—	(2,114)
Change in net interest income	<u>\$ 460</u>	<u>\$ 35</u>	<u>\$ 54</u>	<u>\$ 549</u>
12/31/01 - 12/31/00				
Interest income	\$ 2,708	\$ (2,500)	\$ (321)	\$ (113)
Interest expense	1,859	(2,193)	—	(334)
Change in net interest income	<u>\$ 849</u>	<u>\$ (307)</u>	<u>\$ (321)</u>	<u>\$ (221)</u>

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

Noninterest income for the period ended December 31, 2002, increased \$787, as compared to the same period of 2001. The increase is primarily due to an increase in the patronage refund from AgFirst Farm Credit Bank (the Bank) and an increase in the gains on the sale of other property owned. The Association recorded \$1,673 in patronage refund and \$261 in a special distribution from the Bank for the twelve months ended December 31, 2002.

Noninterest expenses for the year ended December 31, 2002, totaled \$3,598, an increase of \$724 or 25.19 percent, compared to \$2,874 the previous year-end. The most significant items contributing to this increase were annual salaries and employee benefits with an increase of \$367, an increase in purchased services of \$411, an increase in the Insurance Fund Premium of \$79 and a decrease in taxes of \$(134), primarily due to state tax refunds.

The Association recorded a provision for income taxes of \$120 for the twelve months ended December 31, 2002, as compared to a benefit of \$(812) for the same period of 2001, an increase of \$932. The increase is primarily due to recognition of \$607 in tax refunds in 2001 relating to the restructuring of the Association.

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 Association must 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 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 sections. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association. The total notes payable to the Bank at December 31,

2002, were \$221,019 as compared to \$208,171 at December 31, 2001. The increase of 6.17 percent during the period is attributable to the increase in loan volume.

The Association had no lines of credit outstanding with third parties as of December 31, 2002.

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, adjustable 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). Adjustable rate mortgages are indexed to U.S. Treasury Rates. Fixed rate loans are priced based on the current cost of Farm Credit debt of similar terms to maturity.

The Association's net interest income as a percentage of average earning assets was 2.96 percent on December 31, 2002, compared to 3.08 percent on December 31, 2001. The change is mainly attributed to a competitive market, which has tightened the margin achieved over the cost of debt.

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, 2002, increased 1.29 percent to \$32,878, from the December 31, 2001, total of \$32,459. The increase is from net income partially offset by cash patronage, the revolvment of allocated retained earnings, and the reduction of capital stock and participation certificates. In addition, this increase was offset by the Association recording \$1,893 in accumulated other comprehensive loss related to a minimum pension liability adjustment. Refer to Note 9 in the notes to the consolidated financial statements section of this annual report for additional information concerning the minimum pension liability.

Total capital stock and participation certificates were \$1,617 on December 31, 2002, compared to \$1,658 on December 31, 2001. This 2.47 percent decrease is attributed to the retirement of protected stock and participation certificates on loans liquidated in the normal course of business and the retirement of excess stock through revolvment.

The Association's permanent capital ratio as of December 31, 2002 was 12.53 percent compared to 11.74 percent on December 31, 2001. Farm Credit Administration (FCA) regulations require all Farm Credit institutions maintain a minimum permanent capital ratio of 7 percent. The permanent capital ratio is calculated by dividing the Association's permanent capital by a risk-adjusted asset base.

FCA regulations also require all Farm Credit institutions to maintain two other minimum capital ratios: total surplus ratio of 7 percent and core surplus ratio of 3.5 percent. The total surplus and core surplus ratios are calculated by dividing total surplus and core surplus as defined in FCA regulations by a risk-adjusted asset base. As of December 31, 2002, the Association's total surplus ratio and core surplus ratio were 11.99 percent and 9.47 percent, respectively, as compared to 11.17 percent and 6.98 percent, respectively, on December 31, 2001.

Annually, the Association establishes minimum Board standard capital ratios. The Association's 2002 minimum standard permanent capital ratio was >11 percent of risk-adjusted assets. The minimum standard total surplus and minimum standard core surplus ratios for 2002 were >11 percent and >6 percent, respectively. As of December 31, 2002, the Association exceeded all minimum standard capital ratios.

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 Florida:

<u>Location</u>	<u>Description</u>	<u>Form of Ownership</u>
5052 Hwy. 90 East Marianna	Administrative/ Branch	Owned
5336 Stewart Street, SE Milton	Branch	Owned
925 W. Washington Monticello	Branch	Owned
102 SE Priest Street Madison	Branch	Owned

Legal Proceedings

Information, if any, to be disclosed in this section is incorporated herein by reference to Note 12 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 7 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, 6, 10 and 12 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 executive officers of the Association:

<u>Senior Officer</u>	<u>Position</u>
James R. Alberts	Chief Executive Officer/ President
Bruce C. Harrison	Chief Financial Officer
Wesley O. Pope	Chief Appraiser
Wade Hayslip	Central/Western Executive Manager
Maitland Remington	Eastern Regional Lending Manager/ Assn. Credit Administration

The business experience for the past five years for executive officers is with the Farm Credit System with the exception of Bruce C. Harrison, who prior to 2002, practiced as a Certified Public Accountant and previously served as Controller for a commercial enterprise.

The total amount of compensation earned by officers as a group during the years ended December 31, 2002, 2001 and 2000, is as follows:

Aggregate Number of Senior Officers	Year	Annual		Total
		Salary	Bonus	
5	2002	\$410,788	\$74,000	\$484,788
6	2001	\$367,645	\$48,634	\$416,279
6	2000	\$364,851	\$57,361	\$422,212

In addition to a base salary, officers may earn additional compensation under incentive plans. The Association's plans are designed to motivate employees to produce progressively higher levels of final net earnings from year to year and to support the Association's organizational objectives and financial goals. At the same time, these plans foster superior performance and team concepts. A copy of the policies is available to shareholders of the Association upon request.

Bonuses are shown in the year earned, which may be different than the year of payment.

Disclosure of the total compensation earned in 2002 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 \$26,789 for 2002, \$13,041 for 2001, and \$25,041 for 2000.

Subject to approval by the board, the Association currently allows the chairman of the board \$400 and directors \$300 honoraria for attendance at meetings, or special assignments and \$200 for committee meetings. Total compensation paid to directors, as a group was \$73,075.

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

James G. Ditty, Chairman, owns, operates and rents a farm in Jackson County and has been a row crop farmer with principal commodities being peanuts and other row crops for the last five years. During 2002, he served 11 days at Association board meetings and 30 days in other official activities and was paid \$11,875. Term of Office: 2001 – 2004

Richard Terry, Vice Chairman, owns and operates a tobacco farm in Madison County. This has been his principal occupation for the past five years. He serves on the board for Madison County Farm Bureau, Farmers' Coop, Inc., Live Oak, Florida and Madison County Tobacco Warehouse. During 2002, he served 11 days at Association board meetings and 14 days in other official activities and was paid \$7,200. Term of Office: 2001 – 2004

Melvin T. Adams owns and operates a farm in Jackson and Holmes Counties and has been a cattle and row crop farmer for the past five years. During 2002, he served 10 days at Association board meetings and 10 days in other official activities and was paid \$5,700. Term of Office: 2000 – 2003

Bobby A. Boutwell is an outside director. He operates a farm supply and fertilizer business in Santa Rosa County, has a cattle operation and rents a farm. During 2002, he served 7 days at Association board meetings and 6 days in other official activities and was paid \$3,900. Term of Office: 2002 – 2005

Ben C. Gilbert owns and operates a farm in Washington County. Principal commodities are hay, timber and small grains. This has been his principal occupation for the past five years. During 2002, he served 11 days at Association board meetings and 9 days in other official activities and was paid \$6,900. Term of Office: 2001 – 2004

Copeland Griswold owns and operates a row crop and timber farm in Santa Rosa County, Florida and has been a farmer for the past five years. During 2002, he served 11 days at Association board meetings and 10 days in other official activities and was paid \$6,300. Term of Office: 2002 – 2005

William Carroll Lamb was an outside director and past Executive Vice President of Florida Forestry Association, Florida Agricultural Council and the Florida Society of Association Executives. He has also served on the boards of Florida Future Farmers of America Foundation, Florida 4-H Foundation and the

Southern Scholarship Foundation. During 2002, he served 3 days at the Association board meetings and 4 days in other official activities and was paid \$2,100. Term of Office: 1999 – 2002

Kenneth McCroan owns and operates a farm in both Jackson and Calhoun Counties, has been a row crop farmer for the past five years, and is Vice President of McCroan Farms. During 2002, he served 11 days at Association board meetings and 16 days in other official activities and was paid \$7,400. Term of Office: 2002 – 2005

Ronald W. Thompson has been a row crop farmer for the past five years and is a partner in Thompson Brothers Angus Farm, Inc. in Jackson County. During 2002, he served 11 days at Association board meetings and 7 days in other official activities and was paid \$5,400. Term of Office: 2000 – 2003

George T. VanPelt's primary occupation for the past five years has been dairy farming. He is co-owner and operator of a dairy farm in Escambia County. Small grains are also grown for feed. He serves as 4-H Camp Trustee, Board member of Pensacola Interstate Fair and a Church Finance Committee Member. During 2002, he served 11 days at Association board meetings and 16 days in other official activities and was paid \$7,400. Term of Office: 2002 – 2005

T. B. Walker has been a dairy, cattle and row crop farmer for the past five years and a partner with Waukeenah Feed and Fertilizer Supply (retail). He serves on the board of Farmers and Merchants Bank in Jefferson County (commercial banking). During 2002, he served 11 days at Association board meetings and 20 days in other official activities and was paid \$8,900. Term of Office: 2000 – 2003

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 11 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 February 19, 2003, 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 1-850-526-4910 or writing Chief Financial Officer, Farm Credit of Northwest Florida, P. O. Box 7000, Marianna, Florida 32447.

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. 503, or writing Patti Trotter, 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.

Report of Independent Accountants



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

Report of Independent Accountants

February 19, 2003

To the Board of Directors and Stockholders
of Farm Credit of Northwest Florida, ACA

We have audited the accompanying consolidated balance sheets of Farm Credit of Northwest Florida, ACA (Association) and its subsidiaries as of December 31, 2002, 2001, and 2000, and the related consolidated statements of income, of changes in members' equity, and of cash flows for each of the three years in the period ended December 31, 2002. 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 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. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Association and its subsidiaries at December 31, 2002, 2001 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2002 in conformity with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

Consolidated Balance Sheets

<i>(dollars in thousands)</i>	December 31, 2002	December 31, 2001	December 31, 2000
Assets			
Cash	\$ 47	\$ 76	\$ 1,423
Loans	256,055	239,988	201,661
Less: allowance for loan losses	5,822	5,859	5,833
Net loans	250,233	234,129	195,828
Accrued interest receivable	2,193	2,425	3,025
Investment in AgFirst Farm Credit Bank	4,259	5,030	4,897
Premises and equipment, net	995	1,070	1,074
Other property owned	—	99	1,458
Other assets	2,296	2,943	2,291
Total assets	\$ 260,023	\$ 245,772	\$ 209,996
Liabilities			
Notes payable to AgFirst Farm Credit Bank	\$ 221,019	\$ 208,171	\$ 174,613
Accrued interest payable	681	778	1,029
Patronage refund payable	1,688	1,618	1,231
Other liabilities	3,757	2,746	2,437
Total liabilities	227,145	213,313	179,310
Commitments and contingencies			
Members' Equity			
Protected borrower equity	317	360	444
Capital stock and participation certificates	1,300	1,298	1,116
Retained earnings			
Allocated	21,288	18,584	17,478
Unallocated	11,866	12,217	11,648
Accumulated other comprehensive income (loss)	(1,893)	—	—
Total members' equity	32,878	32,459	30,686
Total liabilities and members' equity	\$ 260,023	\$ 245,772	\$ 209,996

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

Consolidated Statements of Income

<i>(dollars in thousands)</i>	For the year ended December 31,		
	2002	2001	2000
Interest Income			
Loans	\$ 16,434	\$ 17,999	\$ 18,112
Interest Expense			
Notes payable to AgFirst Farm Credit Bank	9,083	11,234	11,568
Other	37	—	—
Total interest expense	9,120	11,234	11,568
Net interest income	7,314	6,765	6,544
Provision for (reversal of) loan losses	—	225	250
Net interest income after provision for (reversal of) loan losses	7,314	6,540	6,294
Noninterest Income			
Loan fees	225	192	124
Fees for financially related services	5	9	11
Patronage refund from AgFirst Farm Credit Bank	1,934	1,442	1,266
Gains (losses) on other property owned, net	105	(245)	1
Miscellaneous	162	246	41
Total noninterest income	2,431	1,644	1,443
Noninterest Expense			
Salaries and employee benefits	2,158	1,791	1,586
Occupancy and equipment	259	252	230
Insurance Fund premium	78	(1)	4
Other operating expenses	1,103	832	689
Total noninterest expense	3,598	2,874	2,509
Income before income taxes	6,147	5,310	5,228
Provision (benefit) for income taxes	120	(812)	373
Net income	\$ 6,027	\$ 6,122	\$ 4,855

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

Consolidated Statements of Changes in Members' Equity

<i>(dollars in thousands)</i>	Protected Borrower Equity	Capital Stock and Participation Certificates	Retained Earnings		Accumulated Other Comprehensive Income	Total Members' Equity
			Allocated	Unallocated		
Balance at December 31, 1999	\$ 559	\$ 1,214	\$ 16,608	\$ 10,875	\$ —	\$ 29,256
Net income				4,855		4,855
Protected borrower equity retired	(115)					(115)
Capital stock/participation certificates issued		123				123
Capital stock/participation certificates retired		(221)				(221)
Patronage distribution						
Cash				(1,218)		(1,218)
Qualified allocated retained earnings			2,842	(2,842)		—
Retained earnings retired			(1,986)			(1,986)
Distribution adjustment			14	(22)		(8)
<hr/>						
Balance at December 31, 2000	444	1,116	17,478	11,648	—	30,686
Net income				6,122		6,122
Protected borrower equity retired	(84)					(84)
Capital stock/participation certificates issued		190				190
Capital stock/participation certificates retired		(8)				(8)
Patronage distribution						
Cash				(1,615)		(1,615)
Nonqualified allocated surplus			2,692	(2,692)		—
Nonqualified retained surplus			1,077	(1,077)		—
Retained earnings retired			(2,846)			(2,846)
Distribution adjustment			183	(169)		14
<hr/>						
Balance at December 31, 2001	360	1,298	18,584	12,217	—	32,459
Comprehensive income						
Net income				6,027		6,027
Minimum pension liability					(1,893)	(1,893)
Total comprehensive income						4,134
Protected borrower equity retired	(43)					(43)
Capital stock/participation certificates issued		177				177
Capital stock/participation certificates retired		(175)				(175)
Patronage distribution						
Cash				(1,685)		(1,685)
Nonqualified allocated surplus			2,246	(2,246)		—
Nonqualified retained surplus			2,447	(2,447)		—
Retained earnings retired			(2,019)			(2,019)
Distribution adjustment			30	—		30
<hr/>						
Balance at December 31, 2002	\$ 317	\$ 1,300	\$ 21,288	\$ 11,866	\$ (1,893)	\$ 32,878

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

Consolidated Statements of Cash Flows

<i>(dollars in thousands)</i>	For the year ended December 31,		
	2002	2001	2000
Cash flows from operating activities:			
Net income	\$ 6,027	\$ 6,122	\$ 4,855
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation on premises and equipment	134	127	125
Provision for (reversal of) loan losses	—	225	250
(Gains) losses on other property owned, net	(105)	245	(1)
(Gains) losses from sale of premises and equipment, net	(67)	—	—
Changes in operating assets and liabilities:			
(Increase) decrease in accrued interest receivable	232	600	(511)
(Increase) decrease in investment in AgFirst Farm Credit Bank	771	(133)	—
(Increase) decrease in other assets	647	(652)	(86)
Increase (decrease) in accrued interest payable	(97)	(251)	110
Increase (decrease) in other liabilities	(882)	309	569
Total adjustments	633	470	456
Net cash provided by (used in) operating activities	6,660	6,592	5,311
Cash flows from investing activities:			
Net (increase) decrease in loans	(16,042)	(38,038)	(9,319)
Purchase of premises and equipment, net	(115)	(123)	(215)
Proceeds from sale of premises and equipment, net	123	—	—
Proceeds from sale of other property owned	142	626	472
Net cash provided by (used in) investing activities	(15,892)	(37,535)	(9,062)
Cash flows from financing activities:			
Advances on (repayment of) notes payable to AgFirst Farm Credit Bank, net	12,848	33,558	8,682
Protected borrower equity retired	(43)	(84)	(115)
Capital stock and participation certificates issued	177	190	123
Capital stock and participation certificates retired	(175)	(8)	(221)
Patronage refunds paid	(1,585)	(1,214)	(1,320)
Retained earnings retired	(2,019)	(2,846)	(1,986)
Net cash provided by (used in) financing activities	9,203	29,596	5,163
Net increase (decrease) in cash	(29)	(1,347)	1,412
Cash, beginning of period	76	1,423	11
Cash, end of period	\$ 47	\$ 76	\$ 1,423
Supplemental schedule of non-cash investing and financing activities:			
Financed sales of other property owned	\$ 62	\$ 488	\$ 112
Loans transferred to other property owned	—	—	2,041
Cash dividends or patronage distributions declared or payable	1,685	1,615	1,218
Supplemental information:			
Interest paid	\$ 9,217	\$ 11,485	\$ 11,458
Taxes paid, net	(78)	29	461
Federal tax refunds related to long-term operations (Note 8)	95	672	—

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:** Farm Credit of Northwest Florida, 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 purposes in the counties of Bay, Calhoun, Escambia, Franklin, Gadsden, Gulf, Holmes, Jackson, Jefferson, Leon, Liberty, Madison, Okaloosa, Santa Rosa, Taylor, Wakulla, Walton, and Washington in the state of Florida.

The Association is a lending institution of the Farm Credit System (the System) which was established by Acts of Congress 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.

The nation is currently served by six Farm Credit Banks (FCBs), each of which has specific lending authorities within its chartered territory, and one Agricultural Credit Bank (ACB) which has nationwide lending authorities. Each FCB and the ACB serve one or more Production Credit Associations (PCAs) that originate and service short- and intermediate-term loans, Federal Land Credit Associations (FLCAs) that originate and service long-term real estate mortgage loans and/or Agricultural Credit Associations (ACAs) that originate both long-term and short- and intermediate-term loans. ACAs may reorganize into a parent-subsidary structure and may operate their long-term mortgage lending activities through a newly created FLCA subsidiary and their short- and intermediate-term lending activities through a newly created PCA subsidiary. PCAs, FLCAs and ACAs are collectively referred to as Associations.

Effective January 1, 2001, pursuant to a plan of restructuring approved by the Farm Credit Administration (FCA) and Association shareholders, the Association reorganized its existing organizational structure. Pursuant to this restructuring, an FLCA and a PCA were formed as wholly owned subsidiaries of the Association. The formation of these subsidiaries enables the Association to take advantage of the tax-exempt status of net income from long-term mortgage operations of the FLCA. This restructuring was accounted for as a reorganization of entities under common control similar to a pooling of interests.

Prior to the restructuring, the ACA was subject to federal and state income tax. As a result of the restructuring, long-term lending activity was separated into a wholly owned FLCA subsidiary, which is exempt from federal and state income tax. The ACA, which is the holding company, along with the wholly owned PCA subsidiary, continue to be subject to income tax.

AgFirst Farm Credit Bank (Bank) and its related Associations are collectively referred to as the "District." The Bank is responsible for supervising the activities of the Association, as well as the other associations operating within the AgFirst District. The District consists of the Bank and twenty-four ACAs, twenty-one of which have reorganized as ACA parent-subsidary structures as of December 31, 2002. Effective January 1, 2003, one additional Association will reorganize as an ACA holding company.

The Association makes short- and intermediate-term loans for agricultural production or operating purposes, and secured long-term real estate mortgage loans, with funding from the Bank.

The 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 to (1) ensure the timely payment of principal and interest on Systemwide debt obligations (Insured debt), (2) 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 (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:** Long-term real estate mortgage loans generally have maturities ranging up to 30 years. 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 either 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 are 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.

Loan origination fees and direct loan origination costs are capitalized and the net fee or cost is amortized over the life of the related loan as an adjustment to yield.

The allowance for loan losses is maintained at a level considered adequate by management to provide for estimated losses inherent in the loan portfolio. 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. Loan principal and interest, when appropriate, are charged against the allowance for loan losses when management believes collection is unlikely.

The allowance for loan losses is based upon 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.

C. Investment in AgFirst Farm Credit Bank: The Association is required to maintain ownership in the Bank in the form of B and 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 life. Estimated useful lives of premises and equipment are summarized as follows:

Buildings and Improvements	40 years
Furniture and Equipment	5 to 10 years
Automobiles and Trucks	4 years
Computer Equipment	3 years

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. 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 the District's defined benefit retirement plan (the 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 \$192, \$182 and \$133 for the years ended December 31, 2002, 2001 and 2000, 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.

The Association records a valuation allowance at the balance sheet dates against that portion of the Association's deferred tax assets that, based on management's best estimates of future events and circumstances, more likely than not (a likelihood of more than 50 percent) will not be realized.

Effective January 1, 2001, the Association formed a tax exempt subsidiary as described in Note 1.

I. Patronage Refund from AgFirst: The Association records patronage refunds from the Bank on an accrual basis.

Note 3 — Loans and Allowance for Loan Losses

A summary of loans follows:

	December 31,		
	2002	2001	2000
Long-term farm mortgage	\$ 28,620	\$ 23,220	\$ 20,789
Production and intermediate-term	209,670	193,039	149,332
Rural home	17,724	17,063	16,846
Farm related business	9,109	14,134	12,947
Aquatic	—	10	16
Processing and marketing	—	18	3,689
Sales contracts	833	851	776
Nonaccruals	3,133	1,725	1,175
Plus: participations purchased	7,214	—	—
Less: participations sold	(20,248)	(10,072)	(3,909)
Total	\$ 256,055	\$ 239,988	\$ 201,661

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, 2002, 2001 and 2000 consisted of the following commodity types:

Commodity Type	December 31,		
	2002	2001	2000
Forestry	39%	45%	47%
Row Crops	12	9	10
Livestock	11	10	10
Rural Home	6	6	8
Peanuts	5	5	5
Horticulture	4	3	5
Dairy	2	3	2
Poultry	1	2	2
Other	20	17	11
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. Long-term 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,		
	2002	2001	2000
Nonaccrual:			
Current as to principal and interest	\$ 934	\$ 1,175	\$ 1,157
Past due	2,199	550	18
Accrual:			
Restructured	312	545	562
90 days or more past due	22	67	—
Total impaired loans	\$ 3,467	\$ 2,337	\$ 1,737

There were no material commitments to lend additional funds to debtors whose loans were classified as impaired at December 31, 2002.

The average recorded investment in impaired loans during 2002, 2001 and 2000 was \$3,741, \$3,564 and \$4,609, respectively. There were no impaired loans at December 31, 2002, 2001 and 2000, which had related specific allowances for loan losses. The Association recognized interest income on impaired loans of \$276 in 2002, \$256 in 2001 and \$567 in 2000.

The Association recognized interest income on nonaccrual loans in the form of cash payments totaling \$41 in 2002 and \$40 in 2000, and none in 2001.

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

	Year Ended December 31,		
	2002	2001	2000
Balance at beginning of year	\$ 5,859	\$ 5,833	\$ 5,818
Provision for (reversal of) loan losses	—	225	250
Loans charged off	(43)	(200)	(297)
Recoveries	6	1	62
Balance at end of year	\$ 5,822	\$ 5,859	\$ 5,833

Note 4 — Investment in AgFirst Farm Credit Bank

The Association is required to maintain ownership in the Bank of Class B and Class C stock as determined by the Bank. The Bank may require additional capital contributions to maintain its capital requirements.

Note 5 — Premises and Equipment

Premises and equipment consisted of the following:

	December 31,		
	2002	2001	2000
Land	\$ 117	\$ 135	\$ 135
Buildings and improvements	1,275	1,355	1,345
Furniture and equipment	886	863	846
	<u>2,278</u>	<u>2,353</u>	<u>2,326</u>
Less: accumulated depreciation	1,283	1,283	1,252
Total	<u>\$ 995</u>	<u>\$ 1,070</u>	<u>\$ 1,074</u>

Note 6 — 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 2.55 percent for LIBOR-based loans, 2.36 percent for Prime-based loans, and the weighted average remaining maturities were 7.2 years and 9.9 years, respectively, at December 31, 2002. The weighted average interest rate on the fixed rate and adjustable rate mortgage (ARM) notes payable which are match funded by the Bank was 4.31 percent and the weighted average remaining maturity was 5.9 years at December 31, 2002. The weighted average interest rate on all interest-bearing notes payable was 3.47 percent and the weighted average remaining maturity was 7.4 years at December 31, 2002.

Variable rate and fixed rate notes payable represent approximately 33.63 percent and 66.37 percent, respectively, of total notes payable at December 31, 2002.

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, 2002, the Association's notes payable were within the specified limitations.

Note 7 — 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 the 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 the lesser of \$1 thousand or two percent of the amount of the loan. 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 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, 2002 were 12.53 percent, 11.99 percent and 9.47 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 Classes A and D Preferred Stock, Classes A, B, and C Common Stock, Classes B and C Participation Certificates and such other classes of equity as may be provided for in amendments to the bylaws in such amounts as may be necessary to conduct the Association's business. All 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, 2002:

Class	Protected	Shares Outstanding	
		Number	Aggregate Par Value
A Common/Nonvoting	Yes	5,132	\$ 26
B Common/Nonvoting	Yes	49,455	247
C Common/Voting	No	222,842	1,114
B Participation Certificates/Nonvoting	Yes	8,714	44
C Participation Certificates/Nonvoting	No	37,269	186
Total Capital Stock and Participation Certificates		323,412	\$ 1,617

Protected common stock and participation certificates are retired at par or face value in the normal 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.

Retained Earnings

The Association maintains an unallocated retained earnings account and an allocated retained earnings account. The Board determines the minimum aggregate amount of these two accounts. At the end of any fiscal year, if the retained earnings accounts otherwise would be less than the minimum amount determined by the Board as necessary to maintain adequate capital reserves to meet the commitments of the Association, the Association shall apply earnings

for the year to the unallocated retained earnings account in such amounts as may be determined necessary by the Board. Unallocated retained earnings are maintained for each borrower to permit liquidation on a patronage basis.

The Association maintains an allocated retained earnings account consisting of earnings held and allocated to borrowers on a patronage basis. In the event of a net loss for any fiscal year, such allocated retained earnings account will be subject to full impairment in the order specified in the bylaws beginning with the most recent allocation.

The Association has a first lien and security interest on all retained earnings account allocations owned by any borrowers, and all distributions thereof, as additional collateral for their indebtedness to the Association. When the debt of a borrower is in default or is in the process of final liquidation by payment or otherwise, the Association, upon approval of the Board, may order any and all retained earnings account allocations owned by such borrower to be applied on the indebtedness.

Allocated equities shall be retired solely at the discretion of the Board; provided, however, that minimum capital standards established by the FCA and the Board are met. Nonqualified retained surplus is considered to be permanently invested in the Association and as such, there is no plan to revolve or retire this surplus. All nonqualified distributions are tax deductible only when redeemed.

At December 31, 2002, allocated members' equity consisted of \$12,827 of qualified surplus, \$4,937 of nonqualified allocated surplus and \$3,524 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 the Board approves another proportionate patronage basis.

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. Amounts not distributed are retained as unallocated members' equity.

Dividends

The Association may declare noncumulative dividends on its capital stock and participation certificates provided the dividend rate does not exceed 20 percent of the par value of the respective capital stock and participation certificates. Such dividends may be paid solely on Classes A or D Preferred Stock, or on all classes of stock and participation certificates.

The rate of dividends paid on Class A Preferred Stock for any fiscal year may not be less than the rate of dividends paid on Classes A, B, or C Common Stock or participation certificates for such year. The rate of dividends on Classes A, B, and C Common Stock and participation certificates shall be at the same rate per share.

Dividends may not be declared if, after recording the liability, the Association would not meet its capital adequacy standards. The Association declared no dividends for any of the periods included in these financial statements.

Transfer

Classes A and D Preferred, Classes A, B, and C Common Stocks, and Classes B and C Participation Certificates may be transferred to persons or entities eligible to purchase or hold such equities.

Impairment

Any net losses recorded by the Association shall first be applied against unallocated members' equity. To the extent that such losses would exceed unallocated members' equity, such losses would be applied consistent with the Association's bylaws and distributed pro rata to each share and/or unit outstanding in the class, in the following order:

1. Class C Common Stock and Class C Participation Certificates
2. Classes A and B Common Stock and Class B Participation Certificates
3. Classes A and D Preferred Stock

Liquidation

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

1. Classes A and D Preferred Stock
2. Classes A, B and C Common Stock, and Classes B and C Participation Certificates

3. Holders of allocated surplus evidenced by qualified written notices of allocation
4. Holders of allocated surplus evidenced by nonqualified written notices of allocation
5. All unallocated surplus issued after January 1, 1995, shall be distributed to past and present Patrons on a patronage basis
6. Any remaining assets of the Association after such distribution shall be distributed ratably to the holders of all classes of stock and participation certificates

E. Other Comprehensive Income (Loss)

The Association reports other comprehensive income (loss) in its Statement of Changes in Members' Equity. For the year ended December 31, 2002, the other comprehensive income (loss) results from a minimum pension liability adjustment of \$1,893 as a result of the funded status of the underlying plan.

Note 8 — Income Taxes

The provision (benefit) for income taxes follows:

	Year Ended December 31,		
	2002	2001	2000
Current:			
Federal	\$ 21	\$ 93	\$ 338
State	(35)	(36)	57
Federal refunds related to long-term lending	(95)	(607)	—
State refunds related to long-term lending	(93)	—	—
	<u>(202)</u>	<u>(550)</u>	<u>395</u>
Deferred:			
Federal	279	(217)	(19)
State	43	(45)	(3)
	<u>322</u>	<u>(262)</u>	<u>(22)</u>
Total provision (benefit) for income taxes	<u>\$ 120</u>	<u>\$ (812)</u>	<u>\$ 373</u>

In connection with the restructuring, deferred tax assets of \$968 relating to the corporate restructuring and long-term lending activities were written off as of January 1, 2001 to reflect the change in tax status. In addition, in connection with the pooling of interests, the Association recorded an adjustment to the deferred tax asset due to a change in accounting methodology for deferred income taxes in the amount of \$1,176. Additionally, during 2001, the Association signed a settlement agreement with the IRS resolving the taxability of the prior years' earnings from its long-term mortgage lending activities. This settlement agreement was modeled after one used by another System ACA to reach a settlement agreement with the IRS in August 2000. As a result of this settlement, the Association recorded tax refunds of \$95 and \$607 in 2002 and 2001, respectively, which are included as components of the current income tax provision. In addition, the Association recorded \$1 and \$204 in 2002 and 2001, respectfully, in interest income related to these federal refunds, which is

included in Miscellaneous Income in the accompanying Consolidated Statements of Income. The Association recorded state tax refunds in the amount of \$93 in 2002 related to long-term lending settlements. The Association recorded \$19 in interest related to these state refunds, which is included in Miscellaneous Income in the accompanying Consolidated Statements of Income.

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,		
	2002	2001	2000
Federal tax at statutory rate	\$ 2,049	\$ 1,805	\$ 1,778
State tax, net	(56)	(25)	36
Patronage distributions	(1,336)	(549)	(1,412)
Tax-exempt FLCA earnings	(1,545)	(1,295)	—
Long-term lending related refunds	(188)	(607)	—
Deferred tax asset adjustment	(1,032)	(208)	—
Change in deferred tax asset valuation allowance	2,327	—	—
Other	(99)	67	(29)
Provision (benefit) for income taxes	<u>\$ 120</u>	<u>\$ (812)</u>	<u>\$ 373</u>

Deferred tax assets and liabilities result from the following at:

	December 31,		
	2002	2001	2000
Allowance for loan losses	\$ 824	\$ 1,326	\$ 461
Loan origination fees	78	106	34
Annual leave	—	11	11
Nonaccrual loan interest	11	8	—
Postretirement benefits other than pensions	—	46	54
Nonqualified patronage distributions	1,951	—	—
Other	95	21	20
Gross deferred tax assets	<u>2,959</u>	<u>1,518</u>	<u>580</u>
Valuation allowance	<u>(2,327)</u>	<u>—</u>	<u>—</u>
Future Bank equity redemption	(382)	(874)	(194)
State income tax	(13)	(27)	—
Pensions	—	(56)	(54)
Depreciation	—	—	(6)
Other	—	(2)	(29)
Gross deferred tax liability	<u>(395)</u>	<u>(959)</u>	<u>(283)</u>
Net deferred tax asset (liability)	<u>\$ 237</u>	<u>\$ 559</u>	<u>\$ 297</u>

At December 31, 2002, deferred income taxes have not been provided by the Association on approximately \$56 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 9 — Employee Benefit Plans

The Association participates in a Districtwide defined benefit retirement plan. This plan is noncontributory and covers substantially all Association employees. Benefits are based on salary and years of service. The assets, liabilities and costs of the plan are not segregated by participating entities but are allocated among the participating entities. Pension costs are allocated by multiplying the District's net pension expense times the Association's salary expense as a percentage of the District's salary expense.

At December 31, 2002, the Accumulated Benefit Obligation (ABO) of the District's defined benefit plan exceeded the fair value of plan assets. In accordance with the provisions of SFAS No. 87, "Employers' Accounting for Pensions", (SFAS No. 87), the recognition of a minimum liability in the amount of the excess of the ABO over the fair value of plan assets is required. At December 31, 2002, the Association's allocated amount of minimum liability of \$1,096 was recognized. In conjunction with the recognition of the minimum liability, a reduction in Other Comprehensive Income of \$1,893 was recorded. The impact on deferred taxes was not significant.

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.

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

	2002	2001	2000
Pension	\$ 240	\$ 1	\$ 19
Thrift/deferred compensation	32	30	28
Other Postretirement benefits	192	182	133
Total	<u>\$ 464</u>	<u>\$ 213</u>	<u>\$ 180</u>

Note 10 — 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.

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, 2002, the assets in the Insurance Fund aggregated \$1.839 billion. However, due to the authorized uses of the Insurance Fund, there is no assurance that such 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 11 — 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, 2002 amounted to \$8,844. During 2002, \$5,665 of new loans were made and repayments totaled \$4,508. In the opinion of management, none of these loans outstanding at December 31, 2002 involved more than a normal risk of collectibility.

Note 12 — Commitments and Contingencies

The Association has various commitments outstanding and contingent liabilities as discussed elsewhere in these Notes to the Consolidated Financial Statements.

Actions are pending against the Association in which money damages are sought. However, on the basis of information now at hand, management and legal counsel are of the opinion that the ultimate liability, if any, resulting therefrom, would not be material in relation to the overall financial position of the Association.

Note 13 — Financial Instruments with Off-Balance-Sheet Risk

The Bank and Associations may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of their borrowers and to manage their exposure to interest-rate risk. These financial instruments include commitments to extend credit. In the normal course of business, various commitments are made to customers, such as commitments to extend credit and letters of credit, which represent credit-related financial instruments with off-balance-sheet risk. At December 31, 2002, \$19,850 of commitments to extend 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 Consolidated 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 the same credit policies are applied by management. 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.

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, 2002, 2001 and 2000. 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, 2002		December 31, 2001	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash	\$ 47	\$ 47	\$ 76	\$ 76
Loans	\$ 256,055	\$ 261,195	\$ 239,988	\$ 239,859
Allowance for loan losses	5,822	—	5,859	—
Loans, net	<u>\$ 250,233</u>	<u>\$ 261,195</u>	<u>\$ 234,129</u>	<u>\$ 239,859</u>

Financial liabilities:				
Notes payable to AgFirst Farm Credit Bank	\$ 221,019	\$ 222,543	\$ 208,171	\$ 206,897

	December 31, 2000	
	Carrying Amount	Estimated Fair Value
Financial assets:		
Cash	\$ 1,423	\$ 1,423
Loans	\$ 201,661	\$ 201,510
Allowance for loan losses	5,833	—
Loans, net	<u>\$ 195,828</u>	<u>\$ 201,510</u>

Financial liabilities:		
Notes payable to AgFirst Farm Credit Bank	\$ 174,613	\$ 175,053

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:** 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 4, 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 2.24 percent of the issued stock of the Bank as of December 31, 2002 net of any reciprocal investment. As of that date, the Bank's assets totaled \$14.7 billion and shareholders' equity totaled \$757 million. The Bank's earnings were \$194 million during 2002.
- 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:** The estimated market value of off-balance-sheet commitments is nominal 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, 2002, 2001 and 2000 follow:

	2002				
	First	Second	Third	Fourth	Total
Net interest income	\$ 1,735	\$ 1,815	\$ 1,906	\$ 1,858	\$ 7,314
Provision for (reversal of) loan losses	—	—	—	—	—
Noninterest income (expense), net	(138)	(272)	(394)	(483)	(1,287)
Net income (loss)	\$ 1,597	\$ 1,543	\$ 1,512	\$ 1,375	\$ 6,027

	2001				
	First	Second	Third	Fourth	Total
Net interest income	\$ 1,656	\$ 1,668	\$ 1,750	\$ 1,691	\$ 6,765
Provision for (reversal of) loan losses	—	—	—	225	225
Noninterest income (expense), net	49	(492)	(333)	358	(418)
Net income (loss)	\$ 1,705	\$ 1,176	\$ 1,417	\$ 1,824	\$ 6,122

	2000				
	First	Second	Third	Fourth	Total
Net interest income	\$ 1,528	\$ 1,595	\$ 1,817	\$ 1,604	\$ 6,544
Provision for (reversal of) loan losses	50	85	75	40	250
Noninterest income (expense), net	(316)	(364)	(435)	(324)	(1,439)
Net income (loss)	\$ 1,162	\$ 1,146	\$ 1,307	\$ 1,240	\$ 4,855