
JACKSON PURCHASE AGRICULTURAL CREDIT ASSOCIATION

2007 ANNUAL REPORT

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Management

Tommy Murphey Chief Executive Officer
Stan Brunston Senior Vice President
Barbara Davis Chief Financial Officer

Board of Directors

Curtis Hancock, Jr. Chairman
Joe Forrest Campbell Vice Chairman
Jeff Davis Director
Randall Heath Director
Dr. Buddy Ray Outside Director
Allen Ross Director
Eddie Workman Director

Message from the President

The 2007 Annual Report is provided for the membership to accurately review the earnings and financial condition of the Association.

The financial condition of the Association continues to improve and remains very strong. The association experienced varied drought conditions in 2007 from mild to fairly severe. The reduced yields were somewhat offset by much improved commodity prices, but overall net farm incomes were not up to previous years levels. Until 2007, the association had experienced four consecutive years of strong net farm earnings and those favorable financial conditions helped borrowers build good equity and enjoy improved liquidity. For the most part, 2007 reduced net earnings did not significantly affect borrowers because of their high levels of crop insurance, but repayment margins were reduced. With the strong financial state of the borrowers as a whole, credit quality actually improved. Acceptable/OEAM credit quality was 97.93% compared to 96.5% and 97.72% for 2006 and 2005, respectively. Nonaccrual accounts are the lowest in the history of the Association at .13% of volume as compared to .35% and .34% for 2006 and 2005, respectively. The Association continues to experience very minimum loan losses with a .005% loss of average volume in 2007 compared to a net recovery of .003% in 2006 and a net charge off of .020% in 2005.

The Association experienced excellent growth in 2007 with a net volume increase of 12.27%. This volume increase was a result of a very balanced marketing strategy. Much of this growth came from land purchases in agricultural expansion, participation in loans with other agricultural lenders, and greater market penetration in the lifestyle/rural home markets. Gross loan volume at December 31, 2007 was \$283,759 compared to \$252,739 and \$240,891 for 2006 and 2005, respectively. With the growth and minimum losses comes stable earnings. Net income for 2007 was \$4,584 compared to \$4,613 and \$4,802 for 2006 and 2005, respectively. Once again the strong earnings in 2007 will allow the Association to generate an excellent patronage distribution to our borrowers. Because of the strong growth, the permanent capital ratio has dropped to 13.64% compared to 14.83% and 15.17% for 2006 and 2005 respectively. The 13.64% is below the Association's optimum target range of 15-20%, but is well above the regulatory level of 7%. Utilizing the 2008 business plan model, projected future earnings will build the permanent capital ratio back within the target range over the next four years. The Association continues to strive toward greater economic efficiencies as the operating cost per hundred remained at \$1.35 compared to \$1.41 and \$1.43 for 2006 and 2005, respectively.


Your Board and management are excited and thankful for the continued success. They continue to establish business objectives, which will ensure the financial strength and prosperity of your Association. In 2008, these objectives continue to pursue the vision of being the premiere lender, not just in agriculture, but in the entire rural area we serve. Some of these objectives continue to include:

- Remain committed to agriculture as the core of our vision
- Priority emphasis on programs and products to increase young, beginning, and small farmers
- Greater involvement in the financing and improvement of rural communities for their future needs
- Continue to reduce the operating rate through greater efficiency, increased volume, and improved fee income
- Manage succession planning to ensure the quality of management and leadership to fulfill the goals and vision
- Improve the return to the borrowers equity
- Maintain the quality of credit within the Association, which will minimize the risk to capital.

We continue to see a tremendous amount of opportunities before us. Our Cooperative structure allows a patronage refund and local governance which should become the benchmark for all financial institutions. With local authority to approve borrower needs and strong internal Farm Credit funding sources, the association brings a major contribution to the overall economy of a community. With opportunities always come challenges: challenges to maintain a quality staff, challenges of adequate capital to grow, and challenges to provide the right products to serve a changing rural economy. In 2008, with the upcoming retirement of the CEO, the Board faces another major challenge in selection of a new CEO. As with challenges in the past, your Board will continue to rely on the promise of God's wisdom to address each challenge as we position the Association to serve the future needs of agriculture and rural America.

We are very thankful for your continued support. Each year with your trust and God's leadership, the Association has become stronger. This has been another great year for your Association and we are thankful for the blessing experienced by the Association. May we always give God the praise for the success He provides. It has been my privilege to have been your CEO for the past 22 years. I pray God's richest blessing on this Association and each of our borrowers. Joshua 1:8, *"This book of the law shall not depart out of thy mouth; but thou shalt meditate therein day and night, that thou mayest observe to do according to all that is written therein: for then thou shalt make thy way prosperous, and then thou shalt have good success."*

God bless,



Tommy Murphey
President

February 28, 2008

Report of Management

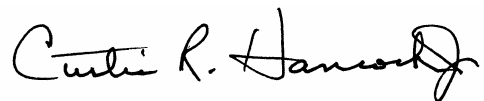
The accompanying consolidated financial statements and related financial information appearing throughout this annual report have been prepared by management of Jackson Purchase Agricultural Credit Association (Association) in accordance with generally accepted accounting principles appropriate in the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

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

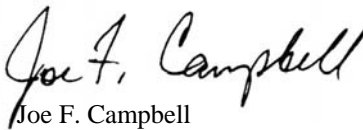
The consolidated financial statements have been examined by independent public auditors, whose report appears elsewhere in this annual report. The Association is also subject to examination by the Farm Credit Administration.

The consolidated financial statements, in the opinion of management, fairly present the financial condition of the Association. The undersigned certify that the 2007 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.

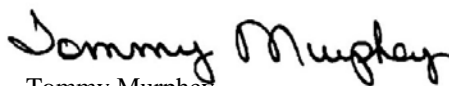
The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors.




Curtis R. Hancock, Jr.
Chairman of the Board



Joe F. Campbell
Member of Board of Directors
Chairman of the Audit Committee



Tommy Murphey
Chief Executive Officer



Barbara Davis
Chief Financial Officer

February 28, 2008

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

(dollars in thousands, except as noted)

GENERAL OVERVIEW

The following commentary summarizes the financial condition and results of operations of Jackson Purchase Agricultural Credit Association (Association) for the year ended December 31, 2007 with comparisons to the years ended December 31, 2006 and December 31, 2005. 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 accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors. For a list of the Audit Committee members, refer to the "Report of the Audit Committee" reflected in this Annual Report. Information in any part of this Annual Report may be incorporated by reference in answer or partial answer to any other item of the Annual Report.

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

The Association is a cooperative, which is owned by the members (also referred to throughout this Annual Report as stockholders or shareholders) served. The territory of the Association extends across a diverse agricultural region of Western Kentucky. Refer to Note 1, "Organization and Operations," of the Notes to the Consolidated Financial Statements for counties in the Association's territory. The Association provides credit to farmers, ranchers, rural residents, and agribusinesses. Our success begins with our extensive agricultural experience and knowledge of the market.

The Association obtains funding from AgFirst Farm Credit Bank (AgFirst or Bank). The Association is materially affected and shareholder investment in the Association could be affected by the financial condition and results of operations of the Bank. Copies of the Bank's Annual and Quarterly Reports are on the AgFirst website, www.agfirst.com, or may be obtained at no charge by calling 1-800-845-1745, extension 378, or writing Stephen Gilbert, AgFirst Farm Credit Bank, P. O. Box 1499, Columbia, SC 29202.

Copies of the Association's Annual and Quarterly reports are also available upon request free of charge on the Association's website, jacksonpurchaseaca.com, or by calling 1-270-247-5613, extension 12, or writing Barbara Davis, Jackson Purchase ACA, P.O. Box 309, Mayfield, KY 42066. The Association prepares an electronic version of the Annual Report, which is available on the website, within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The Association prepares an electronic version of the Quarterly report within 40 days after the end of each fiscal quarter, except that no report needs to be prepared for the fiscal quarter that coincides with the end of the fiscal year of the Association.

FORWARD LOOKING INFORMATION

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

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

AGRICULTURAL OUTLOOK

In November 2007, the United States Department of Agriculture (USDA) estimated that 2007 farmers' net cash income (a measure of cash income after payment of business expenses) increased to \$85.7 billion, up \$17.8 billion from the 2006 forecast and up \$20.3 billion from its 10 year average. Contributing to this sizeable increase in net cash income were increases in cash receipts for crops and livestock of \$22.6 billion and \$20.3 billion, respectively, an increase in farm-related income of \$300 million, offset in part by an increase in cash expenses of \$21.7 billion and a decrease in direct government payments of \$3.7 billion. Corn prices have risen as a result of a combination of continued food and feed demand and expanding ethanol demand. Other crop prices, in general, were positively impacted by increased acreage used to plant corn, decreasing the amount of acreage available for other crops. Wheat and soybeans compete with corn as a feed source so both wheat and soybean prices have risen since late 2006. Livestock cash receipts increased as domestic and export demand for beef have risen. The following table, which is based on information published by the USDA, sets forth the commodity prices per bushel for certain crops and by hundredweight for beef cattle from December 31, 2004 to December 31, 2007:

Commodity	12/31/07	12/31/06	12/31/05	12/31/04
Corn	\$3.76	\$3.01	\$1.92	\$2.04
Soybeans	\$10.00	\$6.18	\$5.77	\$5.45
Wheat	\$7.74	\$4.52	\$3.54	\$3.39
Beef Cattle	\$88.90	\$83.10	\$93.30	\$86.80

Rising commodity prices can have both positive and negative impacts on the Association, as a lender to the agricultural and rural sectors. Higher commodity prices have resulted in increased seasonal demand for agribusiness loans. Higher grain prices positively impact grain farmers. However, higher feed costs negatively impact the profitability of livestock producers, as well as those who use corn or other grains as ingredients in processed foods. To date, this has not significantly affected the Association's credit quality. In addition to higher feed costs, most other production cash expenses, such as fertilizer, seed, energy and labor costs, are forecast to rise further in 2008.

The USDA's 2007 income outlook showed a great deal of variation depending on farm size, geographic location and commodity specialties. While we utilized the USDA analysis to provide a general understanding of the U.S. agricultural economic outlook, this outlook does not take into account all aspects of our business.

The USDA classifies all farms into three primary categories: commercial farms, intermediate farms and rural residential farms. Commercial farms represent about 11 percent of U.S. farms by number and represent 75 percent of total U.S. farm production. Intermediate farms (where the primary occupation is farming and gross sales are below \$250,000) represent 26 percent of U.S. farms by number and account for 16 percent of total production. The remaining 63 percent of U.S. farms are classified as rural residential farms and only account for 9 percent of total production.

In addition to farmers' net cash income, off-farm income is an important source of repayment for farm debt obligations and is less subject to cycles in agriculture. The USDA measures farm household income, which is defined as earnings from farming activities plus off-farm income. Nearly 100 percent of farm household income for operators of rural residential farms and more than 80 percent of farm household income for intermediate farms is generated from off-farm sources. Further, USDA data suggests that about 30 percent of farm household income for commercial farms is generated from off-farm income. USDA estimated 2007 farm household income to increase 21 percent for commercial farms, 8 percent for intermediate farms and 4 percent for rural residential farms.

According to the USDA, farm business balance sheets have shown improvement over the last few years, as measured by debt relative to assets and equity levels. Farmers' equity (farm business assets less farm business debt) is expected to have increased in 2007. One measure of the financial health of the agricultural sector used by the USDA is the assessment of farmers' utilization of their capacity to repay debt (actual debt as a percentage of maximum debt that can be supported by farmers' current income). Higher capacity utilization rates indicate tighter cash flow positions and, consequently, higher exposure to financial risk. These estimates do not take into account, however, off-farm income sources. Since 1970, debt repayment capacity utilization has ranged from a low of 35.8 percent in 1973 to 104.1 percent in 1981, and has remained relatively stable since 1987, averaging about 50 percent. The USDA suggests a decrease in the use of repayment capacity from 57 percent in 2006 to 48 percent in 2007.

Farm business debt, defined by the USDA as debt incurred by those involved in on-farm agricultural production, is estimated to have grown 3.8 percent in 2007, the fourth consecutive year of rising farm debt, following a rise of 7.3 percent in 2006. The recent rise in debt can be at least partially attributed to farmers' positive view of the sector's future. Farm real estate debt accounted for approximately 53 percent of all farm debt for 2007 and 2006.

In general, agriculture has experienced a long period of favorable economic conditions, due to stronger commodity prices, higher land values, and, to a lesser extent, government support programs. To date, the Association's financial results and credit quality have been positively impacted by these conditions. Production agriculture, however, remains a cyclical business that is heavily influenced by commodity prices. In some areas, land values recently have been negatively affected by less favorable economic conditions. Economic conditions in agriculture may not be as favorable in the near future. In an environment of adverse economic conditions in agriculture and without sufficient government support programs, the Association's financial performance and credit quality measures would likely be negatively impacted. However, any negative impacts should be lessened by geographic and commodity diversification and the substantial influence of off-farm income sources supporting agricultural-related debt.

CRITICAL ACCOUNTING POLICIES

The financial statements are reported in conformity with accounting principles generally accepted in the United States of America. Our significant accounting policies are critical to the understanding of our results of operations and financial position because some accounting policies require us to make complex or subjective judgments and estimates that may affect the value of certain assets or liabilities. We consider these policies critical because management must make judgments about matters that are inherently uncertain. For a complete discussion of significant accounting policies, see Note 2, "Summary of Significant Accounting Policies," of the Notes to the Consolidated Financial Statements. The following is a summary of certain critical policies.

- *Allowance for loan losses* — The allowance for loan losses is management's best estimate of the amount of probable losses existing in and inherent in our loan portfolio. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through allowance reversals and loan charge-offs. The allowance for loan losses is determined based on a periodic evaluation of the loan portfolio, which generally considers relevant historical charge-off experience adjusted for relevant factors. These factors include types of loans, credit quality, specific industry conditions, general economic and political conditions, and changes in the character, composition, and performance of the portfolio, among other factors.

Significant individual loans are evaluated based on the borrower's overall financial condition, resources, and payment record, the prospects for support from any financially responsible guarantor, and, if appropriate, the estimated net realizable value of any collateral. The allowance for loan losses attributable to these loans is established by a process that estimates the probable loss inherent in the loans, taking into account various historical and projected factors, internal risk ratings, regulatory oversight, and geographic, industry and other factors.

Changes in the factors considered by management in the evaluation of losses in the loan portfolios could result in a change in the allowance for loan losses and could have a direct impact on the provision for loan losses and the results of operations.

- *Valuation methodologies* — Management applies various valuation methodologies to assets and liabilities that often involve a significant degree of judgment, particularly when liquid markets do not exist for the particular items being valued. Quoted market prices are referred to when estimating fair values for certain assets for which an observable liquid market exists, such as most investment securities. Management utilizes significant estimates and assumptions to value items for which an observable liquid market does not exist. Examples of these items include impaired loans, pension and other postretirement benefit obligations, and certain other financial instruments. These valuations require the use of various assumptions, including, among others, discount rates, rates of return on assets, repayment rates, cash flows, default rates, costs of servicing and liquidation values. The use of different assumptions could produce significantly different results, which could have material positive or negative effects on the Association's results of operations.

- *Pensions* — The Bank and its related Associations participate in defined benefit retirement plans. These plans are noncontributory and benefits are based on salary and years of service. In addition, the Bank and its related Associations also participate in defined contribution retirement savings plans. Pension expense for all plans is recorded as part of salaries and employee benefits. Pension expense for the defined benefit retirement plans is determined by actuarial valuations based on certain assumptions, including expected long-term rate of return on plan assets and discount rate. The expected return on plan assets for the year is calculated based on the composition of assets at the beginning of the year and the expected long-term rate of return on that portfolio of assets. The discount rate is used to determine the present value of our future benefit obligations. The discount rate was selected by reference to Hewitt Associates, (a global Human Resource Services Provider), corporate bond index, actuarial analyses and industry norms.

ECONOMIC CONDITIONS

During 2007, much of our territory experienced mild to severe drought conditions. Even with the drought conditions, most areas produced average corn yields; however, soybean yields were moderately to severely reduced. Because of the strong demand for corn, wheat and soybeans, commodity prices were high enough to still generate very strong net farm earnings across most of the territory. The high commodity prices are primarily driven by our Nation's desire to be less dependent on foreign oil, therefore directing much of the corn supply to ethanol and soybeans to biodiesel. Because of the higher feed cost created by the demand on the corn supply, the broiler and swine industries are beginning to struggle as higher feed cost have greatly reduced profit margins. With the drought conditions affecting grazing and with high commodity prices impacting feed costs, the beef cattle industry saw reduction in net farm profits. The contribution of the TTPP (Tobacco Transition Payment Program) was evident in the third payment and the fourth payment coming January 2008. The tobacco industry has changed dramatically and now has fewer, but very large producers who have experienced favorable net profit margins in 2007.

Agricultural real estate continued to sell at a premium. Agricultural land and rent values have been heavily influenced by recent sharp gains in the commodity market for corn, wheat and soybeans. Other contributing factors to increased land prices are adjoining land owners, urbanization, TTPP, and lifestyle (hobby) farmers. Real estate values continued to increase in the 5%-8% range, but with several extreme (above 10%) not uncommon in 2007. The demand for real estate remained very strong in 2007 and continues. With the sluggish overall economy, housing starts have slowed below those experienced in 2004-2006. For homes less than 10 years old, values have remained fairly stable, but older homes have seen some devaluation with the lack of qualified buyers as a result of tighter underwriting standards after the sub prime market collapse.

Growth within the Association was a healthy blend of loan participations and targeted markets of real estate and lifestyle along with expanded agricultural production. Targeted marketing has proven successful and efforts continued to expand services, increase public awareness of products and streamline delivery systems to further gain market share.

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 through numerous product types.

The diversification of the Association loan volume by type for each of the past three years is shown below.

Loan Type	2007		December 31, 2006		2005	
	<i>(dollars in thousands)</i>					
Real estate mortgage	\$ 88,843	31.31%	\$ 77,984	30.85%	\$ 76,520	31.77%
Production and intermediate-term	137,542	48.47	117,758	46.59	112,787	46.82
Processing and marketing	14,425	5.08	5,301	2.10	2,175	0.90
Farm-related business	11,326	3.99	17,183	6.80	11,849	4.92
Rural residential real estate	31,623	11.15	34,513	13.66	37,560	15.59
Total	\$ 283,759	100.00%	\$ 252,739	100.00%	\$ 240,891	100.00%

While we make loans and provide financially related services to qualified borrowers in the agricultural and rural sectors and to certain related entities, our loan portfolio is diversified.

The geographic distribution of the loans by branch for the past three years is as follows:

Branch	December 31,		
	2007	2006	2005
Bardwell	9.04%	8.87%	8.90%
Clinton	11.96	12.89	12.93
Hickman	9.34	9.83	10.85
Kevil	10.47	11.89	12.69
Murray	18.06	18.26	15.89
Lone Oak	1.11	1.85	1.97
Mayfield	21.99	24.01	24.81
Marshall County	2.02	1.13	1.21
Special Assets Unit	16.01	11.27	10.75
	100.00%	100.00%	100.00%

Commodity and industry categories are based upon the Standard Industrial Classification system published by the federal government. The system assigns commodity or industry categories based upon the largest agricultural commodity of the customer.

The major commodities in the Association loan portfolio are shown below. The predominant commodities are row crops, poultry, rural home, tobacco, and livestock, which constitute 79 percent of the entire portfolio.

Commodity Group	2007		December 31, 2006		2005	
	<i>(dollars in thousands)</i>					
Row Crops	\$ 119,718	42%	\$ 107,080	42%	\$ 100,224	42%
Poultry	35,665	13	31,393	12	33,274	14
Rural Home	33,300	12	36,513	15	41,179	17
Other	35,322	12	28,420	11	25,427	10
Tobacco	18,297	6	16,812	7	15,997	7
Livestock	17,887	6	17,799	7	13,889	6
Sawmills, Paper and Forestry	12,689	5	6,483	3	2,781	1
Animal Specialties	10,881	4	8,239	3	8,120	3
Total	\$ 283,759	100%	\$ 252,739	100%	\$ 240,891	100%

Repayment ability is closely related to the commodities produced by our borrowers, and increasingly, the off-farm income of borrowers. The Association's loan portfolio contains a concentration of corn and soybean producers. Although a large percentage of the loan portfolio is

concentrated in these enterprises, many of these operations are diversified within their enterprise and/or with crop production that reduces overall risk exposure. Demand for beef, prices of field grains, and international trade are some of the factors affecting the price of these commodities. Even though the concentration of large loans has increased over the past several years, the agricultural enterprise mix of these loans is diversified and similar to that of the overall portfolio. The risk in the portfolio associated with commodity concentration and large loans is reduced by the range of diversity of enterprises in the Association's territory.

The increase in gross loan volume for the twelve months ended December 31, 2007, is primarily attributed to loan participations, expanded cost of agricultural production and real estate purchases by agricultural producers and lifestyle farmers.

For the past few years, the Association has experienced a shift in loan assets. The long-term volume trend has been downward while the short and intermediate-term loan volume trend is upward. The short-term portfolio, which is heavily influenced by operating-type loans, normally reaches a peak balance in August and rapidly declines in the fall months as commodities are marketed and proceeds are applied to repay operating loans.

During 2007, the Association increased activity in the buying and selling of loan participations within and outside of the System. This provides a means for the Association to spread credit concentration risk and realize non-patronage sourced interest and fee income, which is intended to strengthen our capital position.

Loan Participations:	December 31,		
	2007	2006	2005
	<i>(dollars in thousands)</i>		
Participations Purchased			
– FCS Institutions	\$ 25,757	\$ 5,527	\$ 7,017
Participations Purchased			
– Non-FCS Institutions	24,107	22,117	15,902
Participations Sold	(24,704)	(5,191)	(1,765)
Total	\$ 25,160	\$ 22,453	\$ 21,154

The Association did not have any loans sold with recourse, retained subordinated participation interests in loans sold, or interests in pools of subordinated participation interests for the year ended December 31, 2007.

The Association sells qualified long-term mortgage loans into the secondary market. For the year ended December 31, 2007, the Association originated loans for resale totaling \$9,744, which were sold into the secondary market, compared to \$13,948 and \$10,017 for the years ended December 31, 2006 and 2005, respectively. The Association additionally purchased portions of loans that are guaranteed by the United States Department of Agriculture and the Small Business Administration. These loans are held for the purposes of reducing interest rate risk and managing surplus short-term funds as allowable under FCA regulations. At December 31, 2007, the balance of these loans, including the unamortized premium, was \$27,043, compared to \$17,164 at December 31, 2006 and \$14,684 at December 31, 2005.

MISSION-RELATED INVESTMENTS

During 2005, the FCA initiated an investment program to stimulate economic growth and development in rural areas. The FCA outlined a program to allow System institutions to hold such investments, subject to approval by the FCA on a case-by-case basis. FCA approved the Rural America Bonds pilot and the Tobacco Buyout Program under the mission-related investments umbrella, as described below.

In October 2005, the FCA authorized AgFirst and the Associations to make investments in Rural America Bonds under a three-year pilot period. Rural America Bonds may include debt obligations issued by public and private enterprises, corporations, cooperatives, other financing institutions, or rural lenders where the proceeds would be used to support agriculture, agribusiness, rural housing, or economic development, infrastructure, or community development and revitalization projects in rural areas. Examples include investments that fund value-added food and fiber processors and marketers, agribusinesses, commercial enterprises that create and maintain employment opportunities in rural areas, community services, such as schools, hospitals, and government facilities, and other activities that sustain or revitalize rural communities and their economies. The objective of this pilot program is to help meet the growing and diverse financing needs of agricultural enterprises, agribusinesses, and rural communities by providing a flexible flow of money to rural areas through bond financing. These bonds may be classified as Loans or Investments on the Consolidated Balance Sheets depending on the nature of the investment. As of December 31, 2007 and December 31, 2006, the Association had \$0 in Rural America Bonds. However, the Association is actively planning to evaluate such opportunities in the future.

On October 22, 2004, Congress enacted the "Fair and Equitable Tobacco Reform Act of 2004" (Tobacco Act) as part of the "American Jobs Creation Act of 2004." The Tobacco Act repealed the Federal tobacco price support and quota programs, provided for payments to tobacco "quota owners" and producers for the elimination of the quota and included an assessment mechanism for tobacco manufacturers and importers to pay for the buyout. Tobacco quota holders and producers will receive equal annual payments under a contract with the Secretary of Agriculture. The Tobacco Act also includes a provision that allows the quota holders and producers to assign to a "financial institution" the right to receive the contract payments (Successor-in-Interest Contracts (SIIC)) so that they may obtain a lump sum or other payment. On April 4, 2005, the United States Department of Agriculture (USDA) issued a Final Rule implementing the "Tobacco Transition Payment Program" (Tobacco Buyout). At December 31, 2007 the Association had \$2,259 in SIIC outstanding compared to \$2,067 and \$1,571 for the years ended December 31, 2006 and 2005, respectively, and these are classified as Other Investments on the Consolidated Balance Sheets. In addition, at December 31, 2007, December 31, 2006, and December 31, 2005, the Association had \$628, \$626, and \$812, respectively, in loans outstanding collateralized by assignments of contract payments.

INVESTMENT SECURITIES

As permitted under FCA regulations, the Association is authorized to hold eligible investments for the purposes of reducing interest rate risk and managing surplus short-term funds. The Bank is responsible for approving the investment policies of the Association. The Bank annually reviews the investment portfolio of every Association that it funds. The Association's investments consist primarily of asset-backed securities (ABS). The ABSs amounted to \$13,627 at December 31, 2007 and \$19,427 at December 31, 2006. For the year ended December 31, 2005, the Association had no ABSs. These ABSs are rated AAA, as they are guaranteed by the full faith and credit of the United States government.

In view of the recent economic conditions and volatility related to these types of securities, the Association is actively monitoring the creditworthiness of these securities. These securities are supported by various forms of credit enhancements including insurance guarantees from AAA rated insurers, over-collateralization and favorable priority of payments. Based on our evaluations, we believe these securities do not pose a significant risk of loss given the credit enhancements and relatively short weighted average lives. However, in the event a security is downgraded, we may be required by our regulator to dispose of the security.

CREDIT RISK MANAGEMENT

Credit risk arises from the potential inability of an obligor to meet its repayment obligation. As part of the process to evaluate the success of a loan, the Association continues to review the credit quality of the loan portfolio on an ongoing basis. With the approval of the Association Board of Directors, the Association establishes underwriting standards and lending policies that provide direction to loan officers. Underwriting standards include, among other things, an evaluation of:

- Character – borrower integrity and credit history
- Capacity – repayment capacity of the borrower based on cash flows from operations or other sources of income
- Collateral – protection for the lender in the event of default and a potential secondary source of repayment
- Capital – ability of the operation to survive unanticipated risks
- Conditions – intended use of the loan funds

The credit risk management process begins with an analysis of the borrower's credit history, repayment capacity, and financial position. Repayment capacity focuses on the borrower's ability to repay the loan based upon cash flows from operations or other sources of income, including non-farm income. Real estate loans must be collateralized by first liens on the real estate (collateral). As required by FCA regulations, each institution that makes loans on a collateralized basis must have collateral evaluation policies and procedures. Real estate mortgage loans may be made only in amounts up to 85 percent of the original appraised value of the property taken as collateral or up to 97 percent of the appraised value if guaranteed by a

state, federal, or other governmental agency. The actual loan to appraised value when loans are made is generally lower than the statutory maximum percentage. Appraisals are required for loans of more than \$250,000. In addition, each loan is assigned a credit risk rating based upon the underwriting standards. This credit risk rating process incorporates objective and subjective criteria to identify inherent strengths, weaknesses, and risks in a particular relationship.

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

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

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

Credit Quality	2007	2006	2005
Acceptable & OAEM	97.93%	96.50%	97.72%
Substandard	2.02%	3.48%	2.28%
Doubtful	0.05%	.02%	–%
Loss	–%	–%	–%
Total	100.00%	100.00%	100.00%

Nonperforming Assets

The Association's loan portfolio is divided into performing and high-risk categories. A Special Assets Management Department is responsible for servicing loans classified as high-risk. The high-risk assets, including accrued interest, are detailed below:

High-risk Assets	December 31,		
	2007	2006	2005
	<i>(dollars in thousands)</i>		
Nonaccrual loans	\$ 377	\$ 894	\$ 825
Restructured loans	15	–	–
Accruing loans 90 days past due	11	–	–
Total high-risk loans	403	894	825
Other property owned	–	–	–
Total high-risk assets	\$ 403	\$ 894	\$ 825
Ratios			
Nonaccrual loans to total loans	0.13%	0.35%	0.34%
High-risk assets to total assets	0.13%	0.31%	0.32%

Nonaccrual loans represent all loans where there is a reasonable doubt as to the collection of principal and/or future interest accruals, under the contractual terms of the loan. In substance,

nonaccrual loans reflect loans where the accrual of interest has been suspended. Nonaccrual loans decreased \$517 or 57.83 percent in 2007. This decrease resulted from normal collection procedures. Of the \$377 in nonaccrual volume at December 31, 2007, \$320 or 84.88%, compared to 57.49% and 88.24% at December 31, 2006 and 2005, respectively, was current as to scheduled principal and interest payments, but did not meet all regulatory requirements to be transferred into accrual status.

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

Allowance for Loan Losses

The allowance for loan losses at each period end was considered by Association management to be adequate to absorb probable losses existing in and inherent to its loan portfolio.

The following table presents the activity in the allowance for loan losses for the most recent three years:

Allowance for Loan Losses Activity:	Year Ended December 31,		
	2007	2006	2005
	<i>(dollars in thousands)</i>		
Balance at beginning of year	\$ 1,052	\$ 1,150	\$ 1,200
Charge-offs:			
Production and intermediate-term	(48)	(1)	(56)
Total charge-offs	(48)	(1)	(56)
Recoveries:			
Production and intermediate-term	35	7	7
Total recoveries	35	7	7
Net (charge-offs) recoveries	(13)	6	(49)
Provision for (reversal of allowance for) loan losses	–	(104)	(1)
Balance at end of year	\$ 1,039	\$ 1,052	\$ 1,150
Ratio of net (charge-offs) recoveries during the period to average loans outstanding during the period	(0.005)%	0.003%	(0.020)%

The net loan charge-offs were primarily associated with normal collection procedures.

The allowance for loan losses by loan type for the most recent three years is as follows:

Allowance for Loan Losses by Type	December 31,		
	2007	2006	2005
	<i>(dollars in thousands)</i>		
Real estate mortgage	\$ 112	\$ 149	\$ 256
Production and intermediate-term	646	520	562
Agribusiness	154	224	85
Rural residential real estate	127	159	247
Total allowance for loan losses	\$ 1,039	\$ 1,052	\$ 1,150

The allowance for loan losses as a percentage of loans outstanding and as a percentage of certain other credit quality indicators is shown below:

Allowance for Loan Losses as a Percentage of:	December 31,		
	2007	2006	2005
Total loans	0.37%	0.42%	0.48%
Nonperforming loans	–%	1,461.11%	–%
Nonaccrual loans	275.60%	117.67%	139.39%

The financial positions of our borrowers have generally strengthened during the past decade as farmers' net cash income has been at a favorable level due, in part, to direct federal government payments and steady increases in land values over the period. With borrowers' strengthened financial positions and the continued emphasis on sound underwriting standards, the credit quality of our loan portfolio has remained healthy. Please refer to Note 4, "Loans and Allowance for Loan Losses," of the Notes to the Consolidated Financial Statements, for further information concerning the allowance for loan losses.

RESULTS OF OPERATIONS

Net Interest Income

Net interest income was \$6,361, \$6,119 and \$5,886 in 2007, 2006 and 2005, respectively. Net interest income is the difference between interest income and interest expense. Net interest income is the principal source of earnings for the Association and is impacted by volume, yields on assets and cost of debt. The effects of changes in average volume and interest rates on net interest income over the past three years are presented in the following table:

Change in Net Interest Income:

	Volume*	Rate	Nonaccrual Income	Total
12/31/07 - 12/31/06				
Interest income	\$ 1,362	\$ 350	\$ (6)	\$ 1,706
Interest expense	(823)	(641)	–	(1,464)
Change in net interest income	\$ 539	\$ (291)	\$ (6)	\$ 242
12/31/06 - 12/31/05				
Interest income	\$ 2,045	\$ 2,079	\$ 3	\$ 4,127
Interest expense	(1,263)	(2,631)	–	(3,894)
Change in net interest income	\$ 782	\$ (552)	\$ 3	\$ 233

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

Noninterest Income

Noninterest income for each of the three years ended December 31 is shown in the following table:

Noninterest Income	For the Year Ended			Percentage	
	December 31,			Increase/(Decrease)	
	2007	2006	2005	2007/ 2006	2006/ 2005
<i>(dollars in thousands)</i>					
Loan fees	\$ 303	\$ 389	\$ 253	(22.11)%	53.75%
Fees for financially related services	513	354	309	44.92	14.56
Patronage refund from other Farm Credit Institutions	2,148	2,002	2,095	7.29	(4.44)
Gains (losses) on sales of rural home loans	15	36	21	(58.33)	71.43
Other noninterest income	37	25	25	48.00	–
Total noninterest income	\$ 3,016	\$ 2,806	\$ 2,703	7.48%	3.81%

Noninterest Expense

Noninterest expense for each of the three years ended December 31 is shown in the following table:

Noninterest Expense	For the Year Ended			Percentage	
	December 31,			Increase/(Decrease)	
	2007	2006	2005	2007/ 2006	2006/ 2005
<i>(dollars in thousands)</i>					
Salaries and employee benefits	\$ 3,190	\$ 2,896	\$ 2,565	10.15%	12.90%
Occupancy and equipment	318	290	280	9.66	3.57
Insurance Fund premiums	339	322	104	5.28	209.62
Other operating expenses	940	891	831	5.50	7.22
Total noninterest expense	\$ 4,787	\$ 4,399	\$ 3,780	8.82%	16.38%

Salaries and employee benefits increased in 2007, as compared with 2006, primarily due to increased costs associated with employee benefit plans, merit and incentive compensation, and employee staffing levels. Noninterest expense increased \$388 or 8.82 percent for December 31, 2007, as compared to the same period of 2006 and increased \$619 or 16.38 percent compared to December 31, 2005. The primary reason for the increase in total noninterest expense is attributable to an increase of 10.15% in salaries and employee benefits and an increase of 9.65% in occupancy and equipment expense.

Income Taxes

The Association recorded a provision for income taxes of \$6 for the year ended December 31, 2007, as compared to a provision of \$17 for 2006 and a provision of \$8 for 2005.

Key Results of Operations Comparisons

Key results of operations comparisons for each of the twelve months ended December 31 are shown in the following table:

Key Results of Operations Comparisons	For the 12 Months Ended		
	12/31/07	12/31/06	12/31/05
Return on average assets	1.63%	1.76%	2.10%
Return on average members' equity	11.68%	12.14%	13.43%
Net interest income as a percentage of average earning assets	2.38%	2.46%	2.70%
Net (charge-offs) recoveries to average loans	(0.005)%	0.003%	(0.020)%

The reduction in the return on average assets is due to growth in the loan portfolio.

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

LIQUIDITY AND FUNDING SOURCES

Liquidity and Funding

The principal source of funds for the Association is the borrowing relationship established with the Bank through a General Financing Agreement (GFA). The GFA 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 (or direct loans) to the Bank. The Bank manages interest rate risk through direct loan pricing and asset/liability management. The notes payable are segmented into variable rate and fixed rate components. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements, as well as certain investments. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association. Association capital levels effectively create a borrowing margin between the amount of loans outstanding and the amount of notes payable outstanding. This margin is commonly referred to as "Loanable Funds." These funds are lendable funds.

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. The liquidity policy of the Association is to manage cash balances to maximize debt reduction and to increase loan volume. As borrower payments are received, they are applied to the Association's note payable to the Bank. The Association's participation in the investments and other secondary market programs provides additional liquidity. Sufficient liquid funds have been available to meet all financial obligations. There are no known trends likely to result in a liquidity deficiency for the Association.

Total notes payable to the Bank at December 31, 2007, was \$261,974 as compared to \$243,292 at December 31, 2006 and \$213,177 at December 31, 2005. The increase of 7.68 percent compared to December 31, 2006 and the increase of 14.13 percent compared to December 31, 2005, was attributable to continued loan growth and investments in the Association. The average volume of outstanding notes payable to the Bank was \$232,822 and \$218,441 for the years ended December 31, 2007 and 2006, respectively. Refer to Note 8, "Notes Payable to AgFirst Farm Credit Bank," of the Notes to the Consolidated Financial Statements, for weighted average interest rates and maturities, and additional information concerning the Association's notes payable.

The Association had no lines of credit from third party financial institutions as of December 31, 2007.

Funds Management

The Bank and the Association manage assets and liabilities to provide a broad range of loan products and funding options, which are designed to allow 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 market indices such as 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 System debt of similar terms to maturity.

The majority of the interest rate risk in the Association's Consolidated Balance Sheets 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

Capital serves to support asset growth and provide protection against unexpected credit and interest rate risk and operating losses. Capital is also needed for future growth and investment in new products and services.

The Association Board of Directors establishes, adopts, and maintains a formal written capital adequacy plan to ensure that adequate capital is maintained for continued financial viability, to provide for growth necessary to meet the needs of members/borrowers, and to ensure that all stockholders are treated equitably. There were no material changes to the capital plan for 2007 that would affect minimum stock purchases or would have an effect on the Association's ability to retire stock and distribute earnings.

Total members' equity at December 31, 2007, increased 4.99 percent to \$39,711 from the December 31, 2006, total of \$37,822. At December 31, 2006, total members' equity increased 3.89 percent from the December 31, 2005 total of \$36,407. The increase was primarily attributed to association earnings.

Total capital stock and participation certificates were \$1,988 on December 31, 2007, compared to \$1,947 on December 31, 2006 and \$2,796 on December 31, 2005. The increase for December 31, 2007 was attributed to the stock requirements on new loan volume, and the decrease for December 31, 2006 was attributed to the Association stock equalization with AgFirst.

FCA sets minimum regulatory capital requirements for System banks and associations. Capital adequacy is evaluated using a number of regulatory ratios. According to the FCA regulations, each institution's permanent capital ratio is calculated by dividing permanent capital by a risk-adjusted asset base. Risk adjusted assets mean the total dollar amount of the institution's assets adjusted by an appropriate credit conversion factor as defined by regulation. For all periods represented, the Association exceeded minimum regulatory standard for all the ratios.

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

	2007	2006	2005	Regulatory Minimum
Permanent capital ratio	13.64%	14.83%	15.17%	7.00%
Total surplus ratio	12.88%	14.00%	14.28%	7.00%
Core surplus ratio	12.26%	13.23%	13.37%	3.50%

The decrease in the Association's permanent capital, total surplus, and core surplus for December 31, 2007 and December 31, 2006 was attributed to increased loan volume and the Association stock equalization with AgFirst. There are no trends, commitments, contingencies, or events that are likely to affect the Association's ability to meet regulatory minimum capital standards and capital adequacy requirements.

See Note 9, "Members' Equity," of the Consolidated Financial Statements, for further information concerning capital resources.

PATRONAGE PROGRAM

Prior to the beginning of any fiscal year, the Association's Board of Directors, by adoption of a resolution, may establish a Patronage Allocation Program to distribute its available consolidated net earnings. This resolution provides for the application of net earnings in the manner described in the Association's Bylaws. This includes the setting aside of funds to increase surplus to meet minimum capital adequacy standards established by FCA Regulations, to increase surplus to meet Association capital adequacy standards to a level necessary to support competitive pricing at targeted earnings levels, and for reasonable reserves for necessary purposes of the Association. After excluding net earnings attributable to (a) the portion of loans participated to another institution, and (b) participation loans purchased, remaining consolidated net earnings are eligible for allocation to borrowers. Refer to Note 9, "Members' Equity," of the Notes to the Consolidated Financial Statements, for more information concerning the patronage distributions. The Association declared patronage distributions of \$4,308 in 2007, \$3,896 in 2006, and \$4,417 in 2005.

YOUNG, BEGINNING AND SMALL (YBS) FARMERS AND RANCHERS PROGRAM

The Association's mission is to provide financial services to agriculture and the rural community, which includes providing credit to young*, beginning** and small*** farmers. Because of the unique needs of these individuals, and their importance to the future growth of the Association, the Association has established annual marketing goals to increase our market share of loans to YBS farmers. Specific marketing plans have been developed to target these groups, and resources have been designated to help ensure YBS borrowers have access to a stable source of credit. As a result, 2007 goals were met.

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

	As of December 31, 2007	
	Number of Loans	Amount of Loans
Young	622	\$40,224
Beginning	551	36,549
Small	1,764	73,099

Note: For purposes of the above table, a loan could be classified in more than one category, depending upon the characteristics of the underlying borrower.

The 2002 USDA (2002 is the latest USDA Ag census data available; next census will be available in 2008.) Ag census data has been used as a benchmark to measure penetration of the Association's marketing efforts. The census data indicated that within the Association's chartered territory (counties) there were 5,370 reported farmers of which by definition 321 or 6.0 percent were Young, 1,390 or 25.9 percent were Beginning, and 4,942 or 92.0 percent were Small. Comparatively, as of December 31, 2007, the demographics of the Association's agricultural portfolio contained 2,101 farmers, of which by definition 406 or 19.3 percent were Young, 375 or 17.8 percent were Beginning and 1,225 or 58.3 percent were Small.

The Association addresses the specific credit programs and partnerships that have been developed to help small farmers, young farmers, and farmers just starting out. It comprised programs offered by:

1. The Farm Service Agency (FSA), which includes guaranteed and direct loans to qualifying borrowers. The Association is a Certified Lender, a status designated by the FSA.
2. Kentucky Agricultural Finance Corporation (KAFC) Beginning Farmer Program - the State of Kentucky has special interest rates for loans up to \$100,000 for YBS in combination with ACA direct loans, with ACA as servicer of the account.
3. Agricultural Infrastructure Loan Program - The State of Kentucky has developed this program for past Tobacco Producers. The program gives a low interest rate on loans up to \$100,000 in combination with ACA direct loans on any infrastructure on their farms. ACA is the servicer of the account.

The Association sponsors local events, such as 4-H and Future Farmers of America (FFA) fairs, or events, where the Association is an exhibitor, such as industry or trade shows.

The Association is also a Guaranteed Participation Lender for the Small Business Administration (SBA), which offers lending programs specifically for small borrowers. Additionally, the Association offers flexible financing options in-house for qualifying borrowers.

The Association is committed to the future success of young, beginning and small farmers.

- * **Young farmers** are defined as those farmers, ranchers, producers or harvesters of aquatic products who are age 35 or younger as of the date the loan is originally made.
- ** **Beginning farmers** are defined as those farmers, ranchers, producers or harvesters of aquatic products who have 10 years or less farming or ranching experience as of the date the loan is originally made.
- *** **Small farmers** are defined as those farmers, ranchers, producers or harvesters of aquatic products who normally generate less than \$250 in annual gross sales of agricultural or aquatic products at the date the loan is originally made.

REGULATORY MATTERS

Proposed Federal Legislation

The current Farm Bill expired on September 30, 2007. In July 2007, the House of Representatives passed its version of a new Farm Bill, the Farm, Nutrition, and Bioenergy Act of 2007. Under the Farm Bill as passed by the House of Representatives, the Congressional Budget Office estimated that payments to farmers under the commodity programs (i.e., direct and countercycle payments and loan deficiency payments) would be reduced by an estimated \$825 million in total over the next 10 years, as compared with a current services baseline of approximately \$75 billion for commodities. However, the specific provisions of the Farm Bill may increase payments for certain commodities or increase them in certain years and reduce them in others. This Farm Bill would also revise certain income payment limitations.

The Farm Bill as passed by the House of Representatives also contains provisions that would expand certain authorities of the Farm Credit System Insurance Corporation. The proposed changes generally would authorize the Insurance Corporation to collect higher levels of premiums and expand the base upon which premiums are charged. Premiums of up to 20 basis points could be charged against insured debt, adjusted to exclude an amount equal to government-guaranteed loans and investment securities. Up to an additional 10 basis points could be charged for any loan volume that is nonaccrual or investments that are other-than-temporarily impaired. Currently, premiums of up to 15 basis points may be charged on accruing loans and up to 25 basis points on nonaccrual loans.

In December 2007, the Senate passed its version of the Farm Bill, the Food and Energy Security Act of 2007. As reported, the bill proposes adjustments to current farm policy while maintaining the basic safety net structure of current law. The bill, when combined with tax provisions previously reported by the Senate Finance Committee, would provide for a permanent disaster fund and provide new incentives for farmers to engage in soil conservation activities. Before these changes are enacted into law, the Senate must conference their actions with the bill earlier approved by the House. It is premature to predict the final outcome of this process. The Senate Farm Bill contains the same expanded authorities with respect to the Insurance Corporation as noted above.

The Senate has named conferees. Conference Committee deliberation, however, awaits the naming of House conferees before it can move forward.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes — an Interpretation of FASB Statement No. 109" (FIN 48 or Interpretation) that was effective for fiscal years beginning after December 15, 2006. FIN 48 clarifies how an enterprise should recognize, measure, present and disclose in its financial statements uncertain tax positions that the enterprise has taken or expects to take on a

tax return. Under the Interpretation, the financial statements reflect expected future tax consequences of income tax positions presuming the relevant taxing authority's full knowledge of the position and all relevant facts, but without considering time values. FIN 48 is applicable to all uncertain positions for taxes accounted for under FASB Statement No. 109. The Association adopted FIN 48 on January 1, 2007 and determined that interest and penalties would be classified as a component of income taxes.

There were no uncertain positions for income taxes at January 1, 2007 identified as a result of the adoption and therefore no cumulative adjustment to beginning members' equity was required. The tax years that remain open for federal and major state income tax jurisdictions are 2004 and forward.

In September 2006, the FASB also issued Statement of Financial Accounting Standards No. 157, "*Fair Value Measurements.*" This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. As a result, there is now a common definition of fair value to be used throughout generally accepted accounting principles. The FASB believes that the new standard will make the measurement of fair value more consistent and comparable and improve disclosures about those measures. This Statement clarifies that the term fair value is intended to mean a market-based measure, not an entity-specific measure. In measuring fair value for a financial statement item, the Statement sets forth a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The highest priority is given to quoted prices in active markets and the lowest priority to unobservable inputs. Additional disclosure requirements will be required for the lowest priority level. The Statement became effective as of January 1, 2008, and will be applied to our consolidated financial statements on a prospective basis.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, "*Fair Value Option for Financial Assets and Financial Liabilities.*" The Standard permits entities to choose on an instrument-by-instrument basis, at specified election dates, to measure financial assets and liabilities and certain other items at fair value (the "fair value option"). Unrealized gains and losses on items for which the fair value option has been elected must be reported in earnings at each subsequent reporting date. Upfront costs and fees related to items for which the fair value option is elected shall be recognized in earnings as incurred and not deferred. This Standard became effective as of January 1, 2008. The Association has not made any elections under the fair value option, thus there will be no impact of the initial adoption of the Standard. However, the Association may elect to apply the fair value option to financial instruments acquired in future periods.

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 of the Consolidated Financial Statements, "Organization and Operations," included in this Annual Report to shareholders.

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.

Description of Property

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

<u>Location</u>	<u>Description</u>	<u>Form of Ownership</u>
328 E. Broadway Mayfield	Administrative	Owned
1401 N. 12th St. Murray	Branch	Owned
1514 Union City Hwy. Hickman	Branch	Owned
12350 Highway 60 West Kevil	Branch	Owned
308 S. Washington St. Clinton	Branch	Leased*
140 State Rt. 123, Suite A Bardwell	Branch	Leased**
3530 Lone Oak Rd, Suite B Paducah	Branch	Leased***
2730 U S Hwy. 641 N Benton	Branch	Owned
545 Dick Castleman Bypass Mayfield	Branch	Owned

* Three-year lease terminating 2/1/08. Monthly payment \$850.00.

** Five-year lease terminating 9/1/08. Monthly payment \$1,075.00.

*** Five-year lease, One-year extension terminating 7/1/08. Monthly payment \$1,275.00.

Legal Proceedings

Information, if any, to be disclosed in this section is incorporated herein by reference to Note 14 of the Consolidated Financial Statements, "Commitments and Contingencies," included in this Annual Report.

Description of Capital Structure

Information to be disclosed in this section is incorporated herein by reference to Note 9 of the Consolidated Financial Statements, "Members' Equity," included in this Annual Report.

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, 8, 12 and 14 of the Consolidated Financial Statements included in this Annual Report.

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 and is to be disclosed in this section, is incorporated herein by reference.

Senior Officers

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

<u>Senior Officer</u>	<u>Position</u>	<u>Years of Service As Senior Officer</u>
Tommy Murphey	Chief Executive Officer	21
Stan Brunston	Senior Vice President	21
Stan Grief	Assistant Vice President	17
Barbara Davis	Chief Financial Officer	21

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

The total amount of compensation earned by the CEO and the highest paid officers as a group during the years ended December 31, 2007, 2006 and 2005, is as follows:

Name of Individual or Number in Group	Year	Annual		Deferred/-		Total
		Salary	Bonus	Perquisites	Other	
Tommy Murphey	2007*	\$158,106	\$26,351	\$3,198	-	\$187,655
Tommy Murphey	2006*	\$143,731	\$20,873	\$2,401	-	\$167,005
5	2007*	\$395,365	\$69,915	-	-	\$465,280
5	2006*	\$378,439	\$54,110	-	-	\$432,549
5	2005	\$424,625	\$87,245	-	-	\$511,870

* Note: Beginning with year-end 2006, CEO compensation must be disclosed as a separate line item and is not included in the aggregate amount. The CEO salary is included in the aggregate amount for 2005.

Regulatory reporting changes have affected the content of the compensation reported for 2006 and those changes may not be reflected in the 2005 amounts.

In addition to a base salary, senior officers earn additional compensation under an incentive plan. The Association incentive plan is designed to motivate employees to exceed the business plan goals during the fiscal year. These goals typically include return on assets, credit quality, credit administration, loan volume, nonaccrual loan volume, permanent capital and other key ratios. Those covered by the plan include all employees. Also all employees except Administrative staff participate in a crop insurance incentive plan designed to motivate employees to increase insurance sales to benefit the member as well as the Association. Additional incentive plans available to all employees include member referral incentives designed to encourage employees to promote new business through personal contacts. Bonuses are shown in the year earned, which may be different than the year of payment.

Disclosure of information on the total compensation paid during 2007 to any senior officer, or to any other individual included in the total, is available to shareholders upon request.

Directors

The following chart details the year the director began serving on the board, the current term of expiration, current committee assignments and total cash compensation paid:

DIRECTOR	ORIGINAL YEAR OF ELECTION OR APPOINTMENT	CURRENT TERM EXPIRATION	TOTAL COMP. PAID DURING 2007
Curtis Hancock, Jr., <i>Chairman</i>	1991	2009	\$ 6,700
Joe Forrest Campbell, <i>Vice-Chairman</i>	2000	2010	9,725
Jeff Davis	1993	2008	6,425
Randall Heath	2006	2010	6,425
Allen Ross	1995	2009	7,525
Eddie Workman	2005	2008	6,975
Buddy D. Ray, <i>Outside Dir.</i>	2003	2010	6,150
			\$ 49,925

The following represents certain information regarding the directors of the Association, including their principal occupation and employment for the past five years. Unless specifically listed, the principal occupation of the board member for the past five years has been as a self-employed farmer.

Mr. Curtis Hancock, Jr., Chairman, operates a row crop program. He serves as a Director for the Farm Credit Council, and serves as Chairman for the Farm Credit Council Services. He also serves on the board for the AgFirst Farm Credit Council.

Mr. Joe Forrest Campbell, Vice Chairman, operates a row crop farming operation. He is a member of the Kentucky and Tennessee Society of Farm Managers and Rural Appraisers and is owner and operator of Campbell Appraisal Services.

Mr. Jeff Davis has a row crop farming operation. Mr. Davis serves on the West Kentucky Rural Telephone Cooperative Board.

Mr. Randall Heath operates row crop farming operation. Mr. Heath serves on the Graves County Farm Bureau Board, Graves County Soil Association, and the Kentucky Farm Bureau Board.

Mr. Allen Ross operates a cattle, row crop and tobacco program. He serves on the Ballard County Cooperative Soil Committee.

Mr. Eddie Workman operates a row crop and tobacco program.

Mr. Buddy D. Ray, DVM, Outside Director, is a veterinarian at the Mayfield Veterinary Clinic. He also serves as Chairman on the Professional Veterinary Products Ltd. Board.

Subject to approval by the board, the Association may allow directors honoraria of \$275 for attendance at meetings, committee meetings, or special assignments. Directors are paid a quarterly retainer fee of \$300. Total compensation paid to directors as a group was \$49,925. No director received more than \$5,000 in non-cash compensation during the year.

The following chart details the number of meetings, other activities and additional compensation paid for other activities (if applicable) for each director:

Name of Director	Days Serve		Committee Assignments	Comp. Paid for other Activities*
	Regular Board Meetings	Other Official Activities*		
Curtis Hancock, Jr., <i>Chairman</i>	10	10	Executive, Audit, Compensation	\$ 3,950
Joe Forrest Campbell, <i>Vice-Chairman</i>	11	20	Credit Review, Audit-Chairman, Compensation	6,700
Jeff Davis	10	9	Audit, Governance, District Advisory	3,675
Randall Heath	11	8	Audit, Governance	3,400
Allen Ross	11	12	Audit, Governance	4,500
Eddie Workman	11	10	Audit	3,950
Buddy D. Ray, <i>Outside Director</i>	10	8	Credit Review, Audit, Compensation	3,400
				\$29,575

* Includes board committee meetings and other board activities other than regular board meetings.

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 \$25,504 for 2007, \$22,989 for 2006, and \$18,702 for 2005

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 13 of the Consolidated Financial Statements, “*Related Party Transactions*,” included in this Annual Report. There have been no transactions between the Association and senior officers or directors which require reporting per FCA regulations.

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. No directors or senior officers have been involved in any legal proceedings during the last five years which require reporting per FCA regulations.

Relationship with Independent Auditors and Other Qualified Public Accountants

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

Aggregate fees paid by the Association for services rendered by its independent auditors and other qualified public accountants for the year ended December 31, 2007 were as follows:

	<u>2007</u>
<i>Independent Auditor</i>	
PricewaterhouseCoopers LLP	
Audit services	\$ 47,440
Total	<u>\$ 47,440</u>

Audit fees were for the annual audit of the consolidated financial statements.

Nonaudit fees were for an internal operations review.

All nonaudit service fees incurred by the Association were approved by the Audit Committee

All other fees were for services rendered in connection with tax services.

Consolidated Financial Statements

The consolidated financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated February 28, 2008 and the report of management, which appear in this Annual Report are incorporated herein by reference.

Copies of the Association’s quarterly reports are available upon request free of charge by calling 1-270-247-5613 or writing Barbara Davis, Jackson Purchase Agricultural Credit Association, P. O. Box 309, Mayfield, KY 42066 or accessing the website, www.jacksonpurchaseaca.com. The Association prepares an electronic version of the Annual Report which is available on the Association’s web site within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The Association prepares an electronic version of the Quarterly report within 40 days after the end of each fiscal quarter, except that no report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution.

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. 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.

Credit and Services to Young, Beginning, and Small Farmers and Ranchers and Producers or Harvesters of Aquatic Products

Information to be disclosed in this section is incorporated herein by reference to the similarly named section in the Management’s Discussion and Analysis of Financial Condition and Results of Operations section included in this Annual Report to the shareholders.

Shareholder Investment

Shareholder investment in the Association could be affected by the financial condition and results of operations of AgFirst Farm Credit Bank (Bank or AgFirst). Copies of the Bank’s Annual and Quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 378, or writing Stephen Gilbert, 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 web site at www.agfirst.com. The Bank prepares an electronic version of the Annual Report, which is available on the website, within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The Bank prepares an electronic version of the Quarterly report within 40 days after the end of each fiscal quarter, except that no report needs to be prepared for the fiscal quarter that coincides with the end of the fiscal year of the Bank.

Report of the Audit Committee

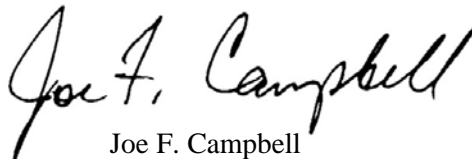
The Audit Committee of the Board of Directors (Committee) is comprised of the directors named below. None of the directors who serve on the Committee is an employee of Jackson Purchase Agricultural Credit Association (Association) and in the opinion of the Board of Directors, each is free of any relationship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

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

PricewaterhouseCoopers LLP (PwC), the Association's independent auditor for 2007, is responsible for expressing an opinion on the conformity of the Association's audited financial statements with accounting principles generally accepted in the United States of America. The Committee has discussed with PwC the matters that are required to be discussed by Statement on Auditing Standards No. 114 (*The Auditor's Communication With Those Charged With Governance*). PwC has provided to the Committee the written disclosures and the letter required by Independence Standards Board Standard No. 1 (*Independence Discussions with Audit Committees*), and the Committee has discussed with PwC that firm's independence.

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

Based on the considerations referred to above, the Committee recommended to the Board of Directors that the audited financial statements be included in the Association's Annual Report for 2007. The foregoing report is provided by the following independent directors, who constitute the Committee:



Joe F. Campbell
Chairman of the Audit Committee

Members of Audit Committee

Jeff Davis
Curtis Hancock
Randall Heath
Dr. Buddy Ray
Allen Ross
Eddie Workman

February 28, 2008

Report of Independent Auditors



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

Report of Independent Auditors

To the Board of Directors and Members
of Jackson Purchase Agricultural Credit Association

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of changes in members' equity and of cash flows present fairly, in all material respects, the financial position of Jackson Purchase Agricultural Credit Association (the Association) and its subsidiaries at December 31, 2007, 2006 and 2005, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

February 28, 2008

Notes to the Consolidated Financial Statements

(dollars in thousands, except as noted)

Note 1 — Organization and Operations

A. **Organization:** Jackson Purchase Agricultural Credit Association (Association) is a member-owned cooperative which provides credit and credit-related services to or for the benefit of eligible borrowers/shareholders for qualified purposes in the counties of Ballard, Calloway, Carlisle, Fulton, Graves, Hickman, Marshall and McCracken in the state of Kentucky.

The Association is a lending institution of the Farm Credit System (System), a nationwide system of cooperatively owned banks and associations, which was established by Acts of Congress to meet the credit needs of American agriculture and is subject to the provisions of the Farm Credit Act of 1971, as amended (Farm Credit Act). The most recent significant amendment to the Farm Credit Act was the Agricultural Credit Act of 1987. At December 31, 2007, the System was comprised of four Farm Credit Banks, one Agricultural Credit Bank and ninety-four Associations.

AgFirst Farm Credit Bank (Bank) and its related Associations are collectively referred to as the "District." The Bank provides funding to associations within the District and is responsible for supervising certain activities of the Association, as well as the other Associations operating within the District. The District consists of the Bank and twenty-three Agricultural Credit Associations (ACAs), all of which are structured as ACA parent-companies, which have two wholly owned subsidiaries, a Federal Land Credit Association (FLCA) and a Production Credit Association (PCA). FLCAs are tax-exempt while ACAs and PCAs are taxable.

The ACA holding company holds a charter for the two wholly-owned subsidiaries, although the Association is operating its short- and intermediate-term business through the ACA instead of the PCA.

ACA parent-companies provide financing and related services through its FLCA and PCA subsidiaries. The FLCA makes collateralized long-term agricultural real estate and rural home mortgage loans. The PCA makes short- and intermediate-term loans for agricultural production or operating purposes.

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

The Farm Credit Act established the Farm Credit System Insurance Corporation (Insurance Corporation) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is required to be used (1) to ensure the timely payment of principal and interest on Systemwide debt obligations (Insured debt), (2) to ensure the retirement of protected borrower capital at par or stated value, and (3) for other specified purposes. The Insurance Fund is also available for discretionary uses by the Insurance Corporation to provide assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation. Each System bank is required to pay premiums, which may be passed on to the Association, into the Insurance Fund, based on its annual average loan principal outstanding until the monies in the Insurance Fund reach the "secure base amount." The secure base amount is defined in the Farm Credit Act as 2.0 percent of the aggregate insured obligations (Systemwide debt obligations) or such other percentage of the aggregate obligations as the Insurance Corporation in its sole discretion determines to be actuarially sound. 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 System 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.

Note 2 — Summary of Significant Accounting Policies

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

Certain amounts in prior years' financial statements have been reclassified to conform to the current year's 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 statements of cash flows, represents cash on hand and on deposit at banks.
- B. **Investment Securities:** The Association, as permitted under the FCA regulations, holds investments for purposes of maintaining a liquidity reserve, managing short-term surplus funds and managing interest rate risk. The Association's investments are classified as held-to-maturity and accordingly have been reported at amortized cost. Purchased premiums and discounts are amortized by a two-step method using constant yield methodologies over a projected cash flow stream.

The Association reviews all investments that are in a loss position in order to determine whether the unrealized loss, which is considered an impairment, is temporary or permanent. In the event of permanent impairment, the cost basis of the investment would be written down to its fair value, and the realized loss would be included in current earnings.

- B. **Loans and Allowance for Loan Losses:** Long-term real estate mortgage loans generally have original maturities ranging from 5 to 40 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 daily principal amount outstanding.

Loans are generally placed in nonaccrual status when principal or interest is delinquent for 90 days (unless adequately collateralized and in the process of collection) or circumstances indicate that collection of principal and/or interest is in doubt. When a loan is placed in nonaccrual status, accrued interest deemed uncollectible is reversed (if accrued in the current year) or charged against the allowance for loan losses (if accrued in the prior year).

When loans are in nonaccrual status, the interest portion of payments received in cash is 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. Nonaccrual loans may be returned 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."

Loans are charged-off, wholly or partially, as appropriate, at the time they are determined to be uncollectible.

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

The allowance for loan losses is a valuation account used to reasonably estimate loan and lease losses existing as of the financial statement date. Determining the appropriate allowance for loan losses balance involves significant judgment about when a loss has been incurred and the amount of that loss.

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

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

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

Impaired loans are loans for which it is probable that not all principal and interest will be collected according to the contractual terms of the loan. Impaired loans include nonaccrual loans, restructured loans, and loans past due 90 days or more and still accruing interest. A loan is considered contractually past due when any principal repayment or interest payment required by the loan instrument is not received on or before the due date. A loan

shall remain contractually past due until it is formally restructured or until the entire amount past due, including principal, accrued interest, and penalty interest incurred as the result of past due status, is collected or otherwise discharged in full.

A specific allowance may be established for impaired loans under Statement of Financial Accounting Standards No. 114. Impairment of these loans is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as practically expedient, at the loan's observable market price or fair value of the collateral if the loan is collateral dependent.

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

C. **Other Investments:** Other investments include Tobacco Buyout Successor-in-Interest Contracts (SIIC), which qualify as mission related investments under FCA regulations. Under the SIIC, the tobacco quota holders and producers may sell their rights to receive SIIC contract payments to a third party. The successor purchases the entire contract and all related rights and obligations associated with the contract. These investments in SIIC are purchased at a discount. Contract payments are made by the United States Department of Agriculture (USDA) in equal annual payments. Interest income is recognized from the accretion of discounts using the effective interest method.

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

E. **Other Property Owned:** Other property owned, consisting of real and personal property acquired through a collection action, is recorded upon acquisition at fair value less estimated selling costs. 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, expenses, and carrying value adjustments related to other property owned are included in gains (losses) on other property owned, net.

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

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

H. **Employee Benefit Plans:** Substantially all employees of the Association, along with three other Associations, may participate in the "Independent Associations' Retirement Plan" (Plan), which is a defined benefit plan, and is considered a multi-employer plan. The Plan is noncontributory and includes eligible District employees. The "Projected Unit Credit" actuarial method is used for financial reporting purposes. The cost of the Plan is allocated based on the individual Association's pension obligation.

Substantially all employees of the Association may also be 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.

Effective January 1, 2006 the Districtwide 401(k) Plan known as the AgFirst Farm Credit Employee Thrift Plan merged with the Farm Credit Bank of Texas Thrift Plus Plan. The new plan is known as the AgFirst/FCBT 401(k) Employee Benefit Plan.

The Association may provide access to certain health care and life insurance benefits to eligible retired employees. Substantially all employees may become eligible for these benefits if they reach early retirement age while working for the Association.

I. **Income Taxes:** The Association is generally subject to Federal income taxes. As previously described, the ACA holding company has two wholly-owned subsidiaries, a PCA and a FLCA. The FLCA subsidiary is exempt from federal and state income taxes as provided in the Farm Credit Act. The ACA holding company and the PCA subsidiary are subject to federal, state 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 accounts for income taxes under the asset and liability method, recognizing 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. The consideration of valuation allowances involves various estimates and assumptions as to future taxable earnings, including the effects of our expected patronage program, which reduces taxable earnings.

J. Patronage Refund from AgFirst and Other Financial Institutions: The Association records patronage refunds from the Bank and certain District Associations on an accrual basis. Patronage receivable is included in Due from AgFirst Farm Credit Bank.

K. Recently Issued Accounting Pronouncements: In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes — an Interpretation of FASB Statement No. 109" (FIN 48 or Interpretation) that was effective for fiscal years beginning after December 15, 2006. FIN 48 clarifies how an enterprise should recognize, measure, present and disclose in its financial statements uncertain tax positions that the enterprise has taken or expects to take on a tax return. Under the Interpretation, the financial statements reflect expected future tax consequences of income tax positions presuming the relevant taxing authority's full knowledge of the position and all relevant facts, but without considering time values. FIN 48 is applicable to all uncertain positions for taxes accounted for under FASB Statement No. 109. The Association adopted FIN 48 on January 1, 2007 and determined that interest and penalties would be classified as a component of income taxes.

There were no uncertain positions for income taxes at January 1, 2007 identified as a result of the adoption and therefore no cumulative adjustment to beginning members' equity was required. The tax years that remain open for federal and major state income tax jurisdictions are 2004 and forward.

In September 2006, the FASB also issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements." This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. As a result, there is now a common definition of fair value to be used throughout generally accepted accounting principles. The FASB believes that the new standard will make the measurement of fair value more consistent and comparable and improve disclosures about those measures. This

Statement clarifies that the term fair value is intended to mean a market-based measure, not an entity-specific measure. In measuring fair value for a financial statement item, the Statement sets forth a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The highest priority is given to quoted prices in active markets and the lowest priority to unobservable inputs. Additional disclosure requirements will be required for the lowest priority level. The Statement became effective as of January 1, 2008, and will be applied to the Association's Consolidated Financial Statements on a prospective basis.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, "Fair Value Option for Financial Assets and Financial Liabilities." The Standard permits entities to choose on an instrument-by-instrument basis, at specified election dates, to measure financial assets and liabilities and certain other items at fair value (the "fair value option"). Unrealized gains and losses on items for which the fair value option has been elected must be reported in earnings at each subsequent reporting date. Upfront costs and fees related to items for which the fair value option is elected shall be recognized in earnings as incurred and not deferred. This Standard became effective as of January 1, 2008. The Association has not made any elections under the fair value option, thus there will be no impact of the initial adoption of the Standard. However, the Association may elect to apply the fair value option to financial instruments acquired in future periods.

Note 3 — Investment Securities

A summary of the amortized cost and fair value of investment securities held-to-maturity at December 31, 2007, 2006 and 2005 follows:

	December 31, 2007				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
Asset backed securities	\$ 13,627	\$ 3	\$ 59	\$ 13,571	5.49%

	December 31, 2006				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
Asset backed securities	\$ 19,427	\$ 9	\$ 80	\$ 19,356	5.53%

The Association's investments consist primarily of asset-backed securities (ABSs). These ABSs are rated AAA, as they are guaranteed by the full faith and credit of the United States government. All unrealized losses referenced above are related to changes in interest rates and are not credit related

The following table shows the fair value and gross unrealized losses for investments in a loss position by the length of time the securities have been in a continuous unrealized loss position at December 31, 2007. The continuous loss position is based on the date the impairment occurred. The unrealized losses on these investments resulted from interest rate volatility and are not credit related. The Association expects to recover substantially all of our cost in these investments. Substantially all of these

investments were in U. S. government securities and we expect that these securities would not be settled at a price less than their amortized cost. Because the decline in market value was caused by changes in interest rate and not credit quality, and because the Association has the ability and intent to hold these investments to maturity, the Association has not recognized any other-than-temporary impairment in connection with these investments

	Less than 12 Months		Greater than 12 Months	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Asset-backed securities	\$ 7,520	\$ 22	\$ 5,163	\$ 36

A summary of the expected maturity, amortized cost and estimated fair value of investment securities at December 31, 2007, follows:

	Amortized Cost	Fair Value	Weighted Average Yield
In one year or less	\$ -	\$ -	-%
After one year through five years	2,841	2,820	5.68
After five years through ten years	10,180	10,153	5.44
After ten years	606	598	5.42
Total	\$ 13,627	\$ 13,571	5.49%

Note 4 — Loans and Allowance for Loan Losses

A summary of loans follows:

	December 31,		
	2007	2006	2005
Real estate mortgage	\$ 88,843	\$ 77,984	\$ 76,520
Production and intermediate term	137,542	117,758	112,787
Processing and marketing	14,425	5,301	2,175
Farm related business	11,326	17,183	11,849
Rural residential real estate	31,623	34,513	37,560
Total loans	\$ 283,759	\$ 252,739	\$ 240,891

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 total loans, 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, 2007, 2006 and 2005 consisted of the following commodity types:

Commodity Type	December 31,		
	2007	2006*	2005*
Row Crops	42%	42%	42%
Poultry	13	12	14
Rural Home	12	15	17
Other	12	11	10
Tobacco	6	7	7
Livestock	6	7	6
Sawmills, Paper & Forestry	5	3	1
Animal Specialties	4	3	3
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 collateralized 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,		
	2007	2006	2005
Nonaccrual loans:			
Current as to principal and interest	\$ 320	\$ 514	\$ 728
Past due	57	380	97
Total nonaccrual loans	377	894	825
Impaired accrual loans:			
Restructured accrual loans	15	-	-
Accrual loans 90 days or more past due	11	-	-
Total impaired accrual loans	26	-	-
Total impaired loans	\$ 403	\$ 894	\$ 825

There were no material commitments to lend additional funds to debtors whose loans were classified as impaired at December 31, 2007.

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

	Year Ended December 31,		
	2007	2006	2005
Interest income recognized on nonaccrual loans	\$ 54	\$ 60	\$ 57
Interest income on impaired accrual loans	13	2	12
Interest income recognized on impaired loans	\$ 67	\$ 62	\$ 69

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

	2007	2006	2005
	Impaired loans with related allowance	\$ 46	\$ 48
Impaired loans with no related allowance	357	846	718
Total impaired loans	\$ 403	\$ 894	\$ 825
Allowance on impaired loans	\$ 5	\$ 5	\$ 25

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

	2007	2006	2005
Average impaired loans	\$ 809	\$ 806	\$ 954

The following table summarizes interest income on nonaccrual and accruing restructured loans that would have been recognized under the original terms of the loans:

	Year Ended December 31,		
	2007	2006	2005
Interest income which would have been recognized under the original loan terms	\$ 99	\$ 131	\$ 113
Less: interest income recognized	54	60	57
Foregone interest income	\$ 45	\$ 71	\$ 56

The changes in the allowance for loan losses are as follows:

	Year Ended December 31,		
	2007	2006	2005
Balance at beginning of year	\$ 1,052	\$ 1,150	\$ 1,200
Charge-offs:			
Production and intermediate term	(48)	(1)	(56)
Total charge-offs	(48)	(1)	(56)
Recoveries:			
Production and intermediate term	35	7	7
Total recoveries	35	7	7
Net (charge-offs) recoveries	(13)	6	(49)
Provision for (reversal of allowance for) loan losses	-	(104)	(1)
Balance at end of year	\$ 1,039	\$ 1,052	\$ 1,150
Ratio of net (charge-offs) recoveries during the period to average loans outstanding during the period	(0.005)%	0.003%	(0.020)%

In addition, the following is a breakdown of the allowance for loan losses for the end of the last three fiscal years:

	December 31, 2007		December 31, 2006	
	Amount	%	Amount	%
Real estate mortgage	\$ 112	11%	\$ 149	14%
Production and intermediate term	646	62	520	50
Agribusiness	154	15	224	21
Rural residential real estate	127	12	159	15
Total	\$ 1,039	100%	\$ 1,052	100%
	December 31, 2005			
	Amount	%		
Real estate mortgage	\$ 256	22%		
Production and intermediate term	562	49		
Agribusiness	85	7		
Rural residential real estate	247	22		
Total	\$ 1,150	100%		

Note 5 — Other Investments

On October 22, 2004, Congress enacted the “Fair and Equitable Tobacco Reform Act of 2004” (Tobacco Act) as part of the “American Jobs Creation Act of 2004.” The Tobacco Act repealed the Federal tobacco price support and quota programs, provides for payments to tobacco “quota owners” and producers for the elimination of the quota, and provides an assessment mechanism for tobacco manufacturers and importers to pay for the buyout. Tobacco quota holders and producers will receive 10 equal annual payments under a contract with the Secretary of Agriculture. The Tobacco Act also includes a provision that allows the quota holders and producers to assign to a “financial institution” the right to receive the contract payments so that they may obtain a lump sum or other payment. On April 4, 2005, the USDA issued a Final Rule implementing the “Tobacco Transition Payment Program” (Tobacco Buyout).

The FCA determined that System institutions are “financial institutions” within the meaning of the Tobacco Act and are, therefore, eligible to participate in the Tobacco Buyout. The FCA recognized that the Tobacco Buyout has significant implications for some System institutions and the tobacco quota holders and producers they serve. The FCA’s goal is to provide System institution borrowers with the option to immediately receive Tobacco Buyout contract payments and reinvest them in future business opportunities.

For the years ended December 31, 2007, 2006 and 2005, the Association held Tobacco Buyout SIIC of \$2,259, \$2,067 and \$1,571, respectively, net of discount.

Note 6 — Investment in AgFirst Farm Credit Bank

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

In 2007 and 2006, the Bank had no reciprocal investment in the Association. In 2005, the Bank had a reciprocal investment in the Association of \$861 representing 172,163 shares of its nonvoting common stock.

Note 7 — Premises and Equipment

Premises and equipment consisted of the following:

	December 31,		
	2007	2006	2005
Land	\$ 290	\$ 259	\$ 243
Buildings and improvements	1,413	1,360	1,177
Furniture and equipment	895	844	810
	2,598	2,463	2,230
Less: accumulated depreciation	1,267	1,151	1,056
Total	\$ 1,331	\$ 1,312	\$ 1,174

Note 8 — 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 5.81 percent for LIBOR-based loans, 5.74 percent for Prime-based loans, and the weighted average remaining maturities were 2.2 years and 3.2 years, respectively, at December 31, 2007. The weighted average interest rate on the fixed rate and adjustable rate mortgage (ARM) loans which are match funded by the Bank was 5.52 percent and the weighted average remaining maturity was 8.7 years at December 31, 2007. The weighted average interest rate on all interest-bearing notes payable was 5.61 percent and the weighted average remaining maturity was 6.5 years at December 31, 2007.

Variable rate and fixed rate notes payable represent approximately 31.03 percent and 68.97 percent, respectively, of total notes payable at December 31, 2007.

Under the Farm Credit Act, the Association is obligated to borrow only from the Bank, unless the Bank approves borrowing from other funding sources. 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, 2007, the Association’s notes payable were within the specified limitations.

Note 9 — Members’ Equity

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

A. 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 Common 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 loan amount. 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.

B. Regulatory Capitalization Requirements and Restrictions

The FCA’s capital adequacy regulations require all system institutions 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, 2007 were 13.64 percent, 12.88 percent and 12.26 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.

C. Description of Equities

The Association is authorized to issue or have outstanding Class A Preferred Stock, Classes B and C Common Stock, 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, 2007:

Class	Protected	Shares Outstanding	
		Number	Aggregate Par Value
B Common/Nonvoting	No	11,500	\$ 58
C Common/Voting	No	337,603	1,688
C Participation Certificates/Nonvoting	No	48,407	242
Total Capital Stock and Participation Certificates		397,510	\$ 1,988

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 minimum aggregate amount of these two accounts is determined by the Board. 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, 2007, allocated members' equity consisted of \$691 of qualified surplus, \$5,916 of nonqualified allocated surplus and \$7,934 of nonqualified retained surplus.

Patronage Distributions

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

If the Association meets its capital adequacy standards after making the patronage distributions, the patronage distributions may be in cash, authorized stock of the Association, allocations of earnings retained in an allocated members' equity account, or any one or more of such forms of distribution. Patronage distributions of the Association's earnings may be paid on either a qualified or nonqualified basis, or a combination of both, as determined by the Board. A minimum of 20 percent of the total qualified patronage distribution to any borrower for any fiscal year shall always be paid in cash. Amounts not distributed are retained as unallocated member's 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 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, or 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. No dividends were declared by the Association for any of the periods included in these financial statements.

Transfer

Classes B and C Common Stocks and Participation Certificates may be transferred to persons or entities eligible to purchase or hold such Stock or Participation Certificates as provided in Section 830 of the Association's bylaws. Class A Preferred Stock may be transferred in the manner set forth in the resolution authorizing the issuance of each Stock.

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. Classes B and C Common Stock and Participation Certificates
2. Class A 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. Holders of Class A Preferred Stock
2. Holders of Classes B and C Common Stock and Participation Certificates
3. Holders of allocated surplus evidenced by qualified written notices of allocation, in the order of the year of issuance, until the total amount of such account has been distributed
4. Holders of nonqualified allocated surplus evidenced by written notices of allocation in the order of the year of issuance, until the total amount of such account has been distributed
5. All unallocated surplus issued after December 12, 1996, shall be distributed to present and former patrons from said date through the date of liquidation 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 in proportion to the number or shares or units of such class of stock or participation certificates held by such holders

Note 10 — Income Taxes

The provision (benefit) for income taxes follows:

	Year Ended December 31,		
	2007	2006	2005
Current:			
Federal	\$ 6	\$ 17	\$ 8
	6	17	8
Deferred:	-	-	-
Total provision (benefit) for income taxes	\$ 6	\$ 17	\$ 8

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,		
	2007	2006	2005
Federal tax at statutory rate	\$ 1561	\$ 1,574	\$ 1,635
Patronage distributions	(664)	(643)	(572)
Tax-exempt FLCA earnings	(912)	(1,131)	(1,064)
Change in deferred tax asset valuation allowance	30	75	1
Other	(9)	142	8
Provision (benefit) for income taxes	\$ 6	\$ 17	\$ 8

Deferred tax assets and liabilities result from the following at:

	December 31,		
	2007	2006	2005
Deferred income tax assets:			
Allowance for loan losses	\$ 217	\$ 228	\$ 218
Annual leave	48	46	46
Pensions and other postretirement benefits	34	36	40
Depreciation	-	8	-
Gross deferred tax assets	299	318	304
Less: valuation allowance	(287)	(257)	(182)
Gross deferred tax assets, net of valuation allowance	12	61	122
Deferred income tax liabilities:			
Pensions and other postretirement benefits	(8)	(61)	(111)
Depreciation	(4)	-	(11)
Gross deferred tax liability	(12)	(61)	(122)
Net deferred tax asset (liability)	\$ -	\$ -	\$ -

At December 31, 2007, deferred income taxes had not been provided by the Association on approximately \$2.9 million of its investment in the Bank. Management expected that these earnings would not be converted to cash.

The Association recorded a valuation allowance of \$287, \$257 and \$182 during 2007, 2006 and 2005, respectively. The Association will continue to evaluate the realizability of these deferred tax assets and adjust the valuation allowance accordingly.

The Association adopted the provisions of the Financial Accounting Standards Board Interpretation No. 48, "Accounting for Uncertainty in Income Taxes," on January 1, 2007. As a result of the adoption, there were no uncertain positions for income taxes identified and therefore the Association recognized no change in the liability for unrecognized tax benefits and no reduction to the January 1, 2007 balance of retained earnings. The Association recognizes interest and penalties related to unrecognized tax benefits as a component of income tax expense. There were no uncertain tax positions identified related to the current year. The tax years that remain open for federal and major state income tax jurisdictions are 2004 and forward.

Note 11 — Employee Benefit Plans

The employees of the Association may participate in a defined benefit retirement plan with three other District associations. This plan, which covers substantially all employees, is noncontributory. Benefits are based on salary and years of service. As a participant in the Independent Associations' Retirement Plan, the Association funded \$0 for 2007, 2006, and 2005, through its note payable to the Bank. Plan expenses included in salaries and employee benefits were \$186 for 2007, \$216 for 2006, and \$181 for 2005. Additional financial information for the Plan may be found in the District's Annual Report.

The Association also participates in a districtwide Thrift Plan. The Thrift Plan requires the Association to match 100 percent of employee optional contributions up to a maximum employee contribution of 6 percent of total compensation. Employee deferrals are not to exceed the maximum deferral as adjusted by the Internal Revenue Service. Employer contributions to this plan were \$131, \$117, and \$108 for the years ended December 31, 2007, 2006 and 2005, respectively.

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. Postretirement benefits other than pensions (primarily health care benefits) included in salaries and employee benefits were \$(7)for 2007, \$(9)for 2006 and \$(4)for 2005. Additional financial information for the Plan may be found in the District's Annual Report.

Note 12 — Intra-System Financial Assistance

The Farm Credit Act provided for capital assistance to System institutions experiencing severe financial stress through the issuance, prior to October 1, 1992, by the Financial Assistance Corporation of U.S. Treasury-guaranteed 15-year bonds, of which \$1.261 billion in principal amount was originally issued. The last remaining Financial Assistance Corporation bonds matured and were repaid on June 10, 2005.

Pursuant to the Farm Credit Act, the U.S. Treasury paid \$440 million, on behalf of the System, in interest costs on \$844 million of the Financial Assistance Corporation bonds issued for purposes other than funding Capital Preservation Agreement accruals. The Banks had irrevocably set aside funds, including interest earned, that totaled the \$440 million needed to repay the interest advanced by the U.S. Treasury. On June 10, 2005, the Banks repaid the U.S. Treasury the interest advanced. The Farm Credit Administrative Board cancelled the Financial Assistance Corporation's charter as of December 31, 2006.

Note 13 — 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, 2007 amounted to \$5,484. During 2007, \$6,635 of new loans were made and repayments totaled \$6,286. In the opinion of management, none of these loans outstanding at December 31, 2007 involved more than a normal risk of collectibility.

Note 14 — Commitments and Contingencies

The Association has various commitments outstanding and contingent liabilities.

The Association may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of its borrowers and to manage their exposure to interest-rate risk. These financial instruments include commitments to extend credit and/or commercial letters of credit. The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the financial statements.

Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. Commercial letters of credit are agreements to pay a beneficiary under conditions specified in the letter of credit. Commitments and letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. At December 31, 2007, \$76,046 of commitments to extend credit and \$0 of commercial letters of credit were outstanding.

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

The Association also participates in standby letters of credit to satisfy the financing needs of its borrowers. These letters of credit are irrevocable agreements to guarantee payments of specified financial obligations. At December 31, 2007, the Association had outstanding \$1,005 of standby letters of credit, with expiration dates ranging from January 12, 2008 to June 1, 2011. The maximum potential amount of future payments the Association may be required to make under these existing guarantees is \$1,005.

A guarantor is required to recognize at the inception of a guarantee, a liability for the fair value of the guarantee commitment. The Association has determined the fair value of the guarantee commitment based upon the fees to be earned over the life of the guarantee. The fair value is updated periodically to reflect changes in individual guarantee amounts and the remaining life to maturity of the individual guarantees in the Association's inventory. At December 31, 2007, the Association's inventory of standby letters of credit had a fair value of \$53 and was included in other liabilities.

Note 15 — 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, 2007, 2006 and 2005. 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, 2007		December 31, 2006	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash	\$ 3,536	\$ 3,536	\$ 4,253	\$ 4,253
Loans	\$ 283,759	\$ 287,572	\$ 252,739	\$ 251,985
Allowance for loan losses	1,039	—	1,052	—
Loans, net	\$ 282,720	\$ 287,572	\$ 251,687	\$ 251,985
Investment securities	\$ 13,627	\$ 13,571	\$ 19,427	\$ 19,356
Tobacco Buyout SIIC	\$ 2,259	\$ 2,321	\$ 2,067	\$ 2,073
Financial liabilities:				
Notes payable to AgFirst Farm Credit Bank	\$ 261,974	\$ 263,450	\$ 243,292	\$ 238,504

	December 31, 2005	
	Carrying Amount	Estimated Fair Value
Financial assets:		
Cash	\$ 4,287	\$ 4,287
Loans	\$ 240,891	\$ 239,458
Allowance for loan losses	1,150	—
Loans, net	\$ 239,741	\$ 239,458
Investment securities	\$ —	\$ —
Tobacco Buyout SIIC	\$ 1,571	\$ 1,587
Financial liabilities:		
Notes payable to AgFirst Farm Credit Bank	\$ 213,177	\$ 209,072

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 Securities:** Fair value is based upon quoted market price.
- D. **Investment in AgFirst Farm Credit Bank and Other Farm Credit Institutions:** Estimating the fair value of the Association's investment in the Bank and Other Farm Credit Institutions is not practicable because the stock is not traded. As described in Note 6, the net investment is a requirement of borrowing from the Bank and is carried at cost plus allocated equities in the accompanying Consolidated Balance Sheets. The Association owns 1.29 percent of the issued stock of the Bank as of December 31, 2007 net of any reciprocal investment. As of that date, the Bank's assets totaled \$26.9 billion and shareholders' equity totaled \$1,457 million. The Bank's earnings were \$192 million during 2007.

In addition, the Association has an investment of \$63 related to other Farm Credit institutions.

- E. **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.

F. Commitments to Extend Credit and Standby Letters of Credit:

The estimated market value of off-balance-sheet commitments is minimal since the committed rate approximates current rates offered for commitments with similar rate and maturity characteristics and since the related credit risk is not significant.

G. Tobacco Buyout SIIC: Fair value is determined by discounting the expected future cash flows using current interest rates for similar assets.

Note 16 — Quarterly Financial Information (Unaudited)

Quarterly results of operations for the years ended December 31, 2007, 2006 and 2005 follow:

	2007				
	First	Second	Third	Fourth	Total
Net interest income	\$ 1,442	\$ 1,525	\$ 1,670	\$ 1,724	\$ 6,361
Provision for (reversal of allowance for) loan losses	-	-	-	-	-
Noninterest income (expense), net	(550)	(583)	(297)	(347)	(1,777)
Net income (loss)	\$ 892	\$ 942	\$ 1,373	\$ 1,377	\$ 4,584

	2006				
	First	Second	Third	Fourth	Total
Net interest income	\$ 1,443	\$ 1,545	\$ 1,583	\$ 1,548	\$ 6,119
Provision for (reversal of allowance for) loan losses	8	-	-	(112)	(104)
Noninterest income (expense), net	(519)	(513)	(334)	(244)	(1,610)
Net income (loss)	\$ 916	\$ 1,032	\$ 1,249	\$ 1,416	\$ 4,613

	2005				
	First	Second	Third	Fourth	Total
Net interest income	\$ 1,400	\$ 1,427	\$ 1,519	\$ 1,540	\$ 5,886
Provision for (reversal of allowance for) loan losses	-	-	-	(1)	(1)
Noninterest income (expense), net	(455)	(404)	(301)	75	(1,085)
Net income (loss)	\$ 945	\$ 1,023	\$ 1,218	\$ 1,616	\$ 4,802