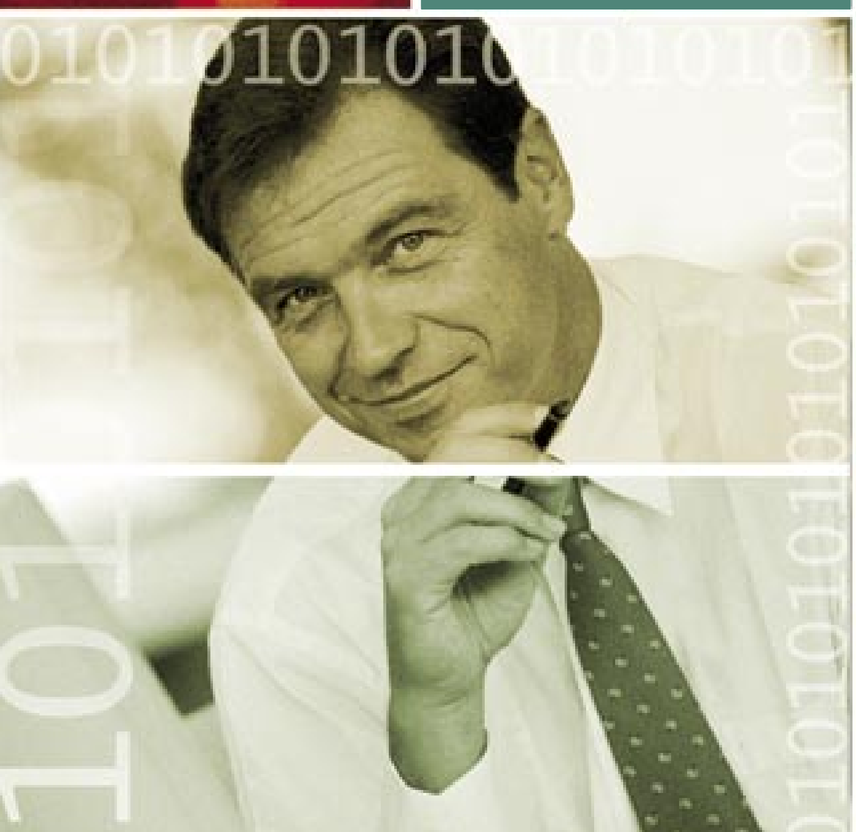
ANNUAL REPORT

AgFirst Farm Credit Bank &
District Associations



2003

AgFirst Farm Credit Bank and District Associations

2003 ANNUAL REPORT

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Management

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Thomas S. Welsh .... Executive Vice President
William R. Clayton .... Senior Vice President

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Message from the Chairman of the Board and Chief Executive Officer

Dear Shareholders:

Farmers face many challenges between planting and harvest. How they deal with those challenges — and the opportunities that come their way — determines how successful they are at year-end. Like the farmer-borrowers we serve, AgFirst Farm Credit Bank and its member-associations found challenges and opportunities in 2003. We worked together to meet our challenges head-on, and we used our unique cooperative structure to take advantage of opportunities. The result — a year of record financial results.

For the fourth consecutive year, our district posted record profits. Our loan volume and market share continued to grow, and our credit quality remained high. The most important measure of our success — patronage refunds paid to borrowers — was $210 million, more than we've paid in any previous year.

Although the general economy continued to struggle in 2003, the agricultural economy was relatively strong. Favorable weather conditions throughout much of the district resulted in high yields for most row crops, and commodity prices improved or remained stable. Poultry, pork and cattle producers saw higher prices and returns in 2003 as inventories of their products declined and demand increased due to the popularity of low-carbohydrate diets.

Borrowers in the AgFirst District benefited from a second year of low interest rates. The year began with the Prime rate at a 40-year low of 4.25 percent. In June, it dropped even lower, to 4.00 percent. Low interest rates encouraged farmers and agribusinesses to expand or refinance their operations, and the home mortgage market saw a record volume of activity.

AgFirst also took advantage of 2003's low rate environment. We refinanced a large volume of our notes and bonds, which decreased our borrowing costs and enabled us to increase our distributions to Associations. Associations likewise continued paying strong patronage refunds to their borrowers. The combined effect of low rates and patronage refunds resulted in the lowest borrowing costs many borrowers have ever known.

Our patronage refund programs are just part of the reason we've seen a significant increase in market share in just two short years. In September 2001, FDIC call report data showed that associations in the AgFirst district had a 48 percent share of the ag loan market, as compared to 52 percent for commercial banks headquartered in our district. Two years later, the numbers have more than reversed: 56 percent for associations versus 44 percent for commercial banks. And, for the second consecutive year, commercial banks recorded a decline in ag loan volume, while associations in the AgFirst district showed a 5.7 percent increase in volume.

As a district, we continue to focus on using technology to improve our operating efficiencies. For example, we have long recognized the advantages of using credit scoring to process small, low-risk loans. Until recently, most associations subscribed to Fair Isaac's popular credit-scoring engine, Credit Desk®, to process those loans. When Fair Isaac announced that it would not support Credit Desk® after September 2004, AgFirst began work to fill that void. The result is a product we call AgScore, a web-based portal to Fair Isaac's LiquidCredit® Small Business Scoring System.

Since we introduced AgScore in September 2003, we've received positive feedback about its ease of use, flexibility, and high-speed performance. Associations throughout our district are enjoying the cost savings and efficiencies it has brought to their operations. We're proud that Farm Credit Leasing and seven Farm Credit associations supported by Financial Partners, Inc. have also contracted with us to use AgScore. They like the fact that their customers are getting quick decisions on their loans, sometimes leaving the office with a check within an hour.

As any farmer can tell you, excellent financial results are not an accident. It takes years of preparation and hard work to realize consistent, high returns. Our staffs and boards have worked hard to position us for success. The seeds they planted years ago helped us realize the bountiful yields we saw in 2003. Their dedication ensures that we will continue to achieve our mission of serving farmers, ranchers and all who live and work in rural America for many years to come.

Paul Lemoine

Paul Lemoine
Chairman of the Board

F. A. Lowrey

F. A. (Andy) Lowrey
Chief Executive Officer

February 24, 2004

Report of Management

The accompanying financial statements and related financial information appearing throughout this annual report have been prepared by management of AgFirst Farm Credit Bank (AgFirst) 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 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 AgFirst 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 AgFirst Farm Credit District 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 Chief Executive Officer.

The financial statements have been examined by independent public accountants, whose report appears elsewhere in this annual report. AgFirst and Associations are also subject to examination by the Farm Credit Administration.

The financial statements, in the opinion of management, fairly present the financial condition of AgFirst and Associations. The undersigned certify that the 2003 Annual Report has been prepared in accordance with all applicable statutory or regulatory requirements and that the information contained herein is true, accurate, and complete to the best of our knowledge and belief.

Paul Lemoine
Chairman of the Board

F. A. Lowrey
Chief Executive Officer

Leon T. Amerson
Chief Financial Officer

February 24, 2004

Five-Year Summary of Selected Combined Financial Data

(UNAUDITED)

(dollars in thousands)	December 31, 2003	2002	2001	2000	1999
Combined Balance Sheet Data					
Cash and cash equivalents	$ 494,339	$ 444,457	$ 339,541	$ 326,204	$ 391,515
Investment securities	2,832,716	2,153,118	1,663,323	2,000,086	2,101,764
Loans	14,369,690	13,823,089	12,877,889	11,095,176	10,164,673
Less: allowance for loan losses	316,735	311,180	301,615	284,867	278,953
Net loans	14,052,955	13,511,909	12,576,274	10,810,309	9,885,720
Other property owned	2,253	4,828	5,925	6,369	8,178
Other assets	313,654	312,689	376,630	379,453	338,962
Total assets	$ 17,695,917	$ 16,427,001	$ 14,961,693	$ 13,522,421	$ 12,726,139
Obligations with maturities of one year or less	$ 6,482,632	$ 6,357,834	$ 8,101,242	$ 6,646,015	$ 6,191,236
Obligations with maturities greater than one year	8,426,554	7,562,772	4,354,069	4,715,193	4,455,931
Mandatorily redeemable preferred stock	225,000	—	—	—	—
Total liabilities	15,134,186	13,920,606	12,455,311	11,361,208	10,647,167
Mandatorily redeemable preferred stock	—	225,839	225,839	—	—
Perpetual preferred stock	150,000	—	—	—	—
Protected borrower equity	12,453	15,486	19,261	23,634	28,297
Capital stock and participation certificates	128,099	124,541	127,271	132,856	152,639
Retained earnings					
Allocated	792,168	756,525	733,378	704,010	659,297
Unallocated	1,587,934	1,494,659	1,393,592	1,302,163	1,249,773
Accumulated other comprehensive income (loss)	(108,923)	(110,655)	7,041	(1,450)	(11,034)
Total shareholders' equity	2,561,731	2,280,556	2,280,543	2,161,213	2,078,972
Total liabilities and equity	$ 17,695,917	$ 16,427,001	$ 14,961,693	$ 13,522,421	$ 12,726,139
Combined Statement of Income Data					
Net interest income	$ 575,913	$ 553,058	$ 484,332	$ 440,656	$ 432,062
Provision for loan losses	8,153	25,263	20,296	7,619	12,312
Noninterest income (expense), net	(248,129)	(215,248)	(160,795)	(198,460)	(201,571)
Net income	$ 319,631	$ 312,547	$ 303,241	$ 234,577	$ 218,179
Combined Key Financial Ratios					
Rate of return on average:					
Total assets	1.88%	2.04%	2.15%	1.85%	1.78%
Total shareholders' equity	13.03%	13.28%	13.67%	11.05%	10.63%
Net interest income as a percentage of average earning assets	3.40%	3.63%	3.46%	3.50%	3.56%
Net chargeoffs (recoveries) to average loans	0.02%	0.12%	0.03%	0.02%	0.03%
Total shareholders' equity to total assets	14.48%	13.88%	15.24%	15.98%	16.34%
Debt to shareholders' equity (:1)	5.91	6.10	5.46	5.26	5.12
Allowance for loan losses to loans	2.20%	2.25%	2.34%	2.57%	2.74%
Permanent capital ratio (Bank only)	25.99%	22.91%	20.70%	16.92%	18.86%
Total surplus ratio (Bank only)	25.79%	22.69%	19.86%	15.50%	16.72%
Core surplus ratio (Bank only)	14.45%	13.20%	10.39%	10.42%	10.89%
Collateral ratio (Bank only)	106.94%	105.94%	106.38%	104.95%	104.93%
Net Income Distribution					
Estimated patronage refunds and dividends:					
Cash	$ 67,792	$ 64,846	$ 70,621	$ 61,185	$ 55,839
Qualified allocated surplus	46,636	50,936	75,336	115,986	112,421
Nonqualified allocated surplus	47,154	42,261	29,946	4,634	—
Nonqualified retained surplus	48,391	32,402	21,165	—	—
Stock dividends	84	90	274	276	800
Mandatorily Redeemable Preferred Stock Dividend	10,282	18,887	10,912	—	—
Perpetual Preferred Stock Dividend	1,851	—	—	—	—

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

(dollars in thousands, except as noted)

This commentary reviews the combined financial condition and results of operations of AgFirst Farm Credit Bank (AgFirst or the Bank) and the District Agricultural Credit Associations (ACAs or Associations), collectively referred to as the District. This information should be read in conjunction with the accompanying combined financial statements, the notes to the combined financial statements, and other sections of this annual report.

Operating Structure

The District is part of the Farm Credit System (the System), the country's oldest Government Sponsored Enterprise (GSE), created by Congress to provide sound, adequate, and constructive credit and closely related services to agriculture and rural America.

AgFirst and each Association are Federally chartered instrumentalities of the United States and are individually regulated by the Farm Credit Administration (the FCA). In creating the System, it was the stated objective of Congress to "*encourage farmer- and rancher-borrowers' participation in the management, control, and ownership of a permanent system of credit for agriculture which will be responsive to the credit needs of all types of agricultural producers having a basis for credit, and to modernize and improve the authorizations and means for furnishing such credit and credit for housing in rural areas made available through the institutions constituting the Farm Credit System.*" Consequently, the Associations are structured as cooperatives; that is, each Association is owned by its borrowers. As such, the benefits of ownership flow to the same farmer/rancher-borrowers that the System was created to serve. Additional information related to the Associations' structure is discussed in Note 1, *Organization and Operations,* of the notes to the combined financial statements in this annual report to shareholders.

As of December 31, 2003, the District was comprised of AgFirst, its wholly owned subsidiary (the Farm Credit Finance Corporation of Puerto Rico), and twenty-four Agricultural Credit Associations (the Associations). AgFirst and the Farm Credit Finance Corporation of Puerto Rico provide funding and related services to the twenty-four Associations who, in turn, provide loans and related services to agricultural and rural borrowers. AgFirst has in place with each of the twenty-four Associations, a revolving line of credit, referred to as a *direct note*. Each Association funds its lending and general corporate activities by borrowing through its direct note. All assets of the Associations secure the direct notes and lending terms are specified in a separate General Financing Agreement between AgFirst and each Association. AgFirst also operates as a cooperative and is owned by the twenty-four Associations. Effective January 1, 2004, AgSouth Farm Credit, ACA merged with Palmetto Farm Credit, ACA. The merged Association is called AgSouth Farm Credit, ACA, and is headquartered in Statesboro, Georgia.

AgFirst and the Associations are chartered to serve eligible borrowers in Alabama, Delaware, Florida, Georgia, Maryland, Mississippi, North Carolina, Pennsylvania, South Carolina, Virginia, West Virginia, Puerto Rico, and portions of Kentucky, Louisiana, Ohio, and Tennessee. Three other Farm Credit Banks and an Agricultural Credit Bank, through a number of associations, provide loans and related services to eligible borrowers in the remaining portion of the United States. While owned by its related associations, each Farm Credit Bank manages and controls its own business activities and operations. Likewise, associations are not commonly owned or controlled and each manages and controls its own business activities and operations. Nevertheless, each Farm Credit Bank and its related associations operate in such an interdependent manner that the financial results of each bank are generally viewed on a combined basis with its related associations.

While combined District statements reflect the financial and operational interdependence of AgFirst and the Associations, it is recognized that AgFirst does not own or control the Associations and may have limited access to Association capital. Therefore, Bank-only financial information (e.g. not combined with the Associations) has been set forth in Note 20, *Bank Only Financial Data,* for the purposes of additional analysis. In addition, AgFirst publishes a Bank-only financial report that may be referred to for a more complete analysis of AgFirst Bank-only financial condition and results of operations.

Financial Condition

Loans

The District's aggregate loan portfolio primarily consists of direct loans made by the Associations to eligible borrowers located within their chartered territories, as illustrated in the following table.

	2003	
(dollars in thousands)	$	%
Association-originated loans	$ 13,047,281	91%
Loan participations purchased	2,759,840	19
Loan participations sold	(1,699,159)	(12)
Other	261,728	2
Total	$ 14,369,690	100%

	2002	
(dollars in thousands)	$	%
Association-originated loans	$ 12,295,709	89%
Loan participations purchased	2,746,347	20
Loan participations sold	(1,565,235)	(11)
Other	346,268	2
Total	$ 13,823,089	100%

	2001	
(dollars in thousands)	$	%
Association-originated loans	$ 11,171,874	87%
Loan participations purchased	2,462,130	19
Loan participations sold	(1,414,881)	(11)
Other	658,766	5
Total	$ 12,877,889	100%

Loans outstanding as of December 31, 2003 totaled $14.4 billion, an increase of 3.95 percent and 11.58 percent compared to December 31, 2002 and 2001, respectively. The growth is consistent with trends in other Farm Credit System institutions and is attributed to a robust agricultural economy, with income bolstered by significant government support for certain crops, commercial banks reducing their exposures to agriculture, and borrowers becoming increasingly aware of the value proposition inherent in Farm Credit's cooperative structure.

The District employs a number of risk management techniques to limit credit exposures. AgFirst and each Association have adopted underwriting standards, individual borrower exposure limits, commodity exposure limits, and other risk management techniques. AgFirst and the Associations actively purchase and sell participations to achieve diversified portfolios and utilize guarantees from other agencies, including Fannie Mae, Farmer Mac, the Farm Services Agency, and the Small Business Administration to further limit credit exposures. At December 31, 2003, the District collectively had $1.2 billion of guaranteed principal under various government or Government Sponsored Enterprises (GSE) guarantee programs.

Affiliated Associations serve all or a portion of fifteen states and Puerto Rico. Additionally, AgFirst and the Associations actively participate in the purchase and sale of loans and loan participations with non-District institutions. The resulting geographic dispersion is a natural risk-reducing factor. The following table illustrates the geographic distribution of the aggregate District portfolio.

State	**2003**	**2002**	**2001**
North Carolina	16%	17%	17%
Florida	14	14	14
Georgia	11	11	12
Virginia	11	11	11
Pennsylvania	10	10	9
South Carolina	7	7	7
Maryland	6	6	6
Ohio	4	4	5
Alabama	3	3	3
Kentucky	3	2	2
Mississippi	2	2	2
Delaware	2	2	2
West Virginia	2	2	2
Puerto Rico	1	1	1
Louisiana	1	1	1
Tennessee	1	1	1
Other	6	6	5
Total	100%	100%	100%

Only five states have 10 percent or more of the total volume. Commodity diversification and borrowers with relatively high levels of non-farm income mitigate the concentration risk in these states.

Credit quality within the District portfolio remained relatively stable during the twelve months ended December 31, 2003. At year-end, the District's net loans were classified as follows:

	2003	**2002**	**2001**
Acceptable	92.81%	92.18%	92.74%
OAEM	4.76	5.22	4.84
Adverse	2.43	2.60	2.42
Total	100.00%	100.00%	100.00%

Acceptable loans are all those that are not criticized. Criticized loans are those that are classified as OAEM, substandard, doubtful, or loss loans. Other Assets Especially Mentioned (OAEM) loan assets are considered fully collectible but have potential weaknesses. Adverse loans include substandard, doubtful, and loss loans.

Delinquencies were .86 percent of total loan assets at year-end 2003 compared to .89 percent at year-end 2002. Nonperforming assets for the District represented .86 percent of total loan assets or $123 million as of December 31, 2003, and .86 percent or $118 million as of December 31, 2002. Nonperforming assets are loans which consist of nonaccrual loans, accruing restructured loans, accruing loans 90 days or more past due, and other property owned.

Net chargeoffs totaled $2.6 million and reflected a $13.2 million decrease compared to the prior year-end. As a percentage of the $14.4 billion in total loan assets, the net chargeoff for the District was only .02 percent.

Although the Farm Credit System receives no direct government support, credit quality is an indirect beneficiary of government support as government program payments to borrowers enhance their ability to honor their commitments. However, due to the geographic location of the District and the resulting types of agriculture, government programs account for a relatively small percentage of net farm income in the territory served by the Associations. In addition, the diversified nature and significant non-farm influence on the District's portfolio mitigate the impact of government support for program crops.

The diversity of income sources supporting loan repayment mitigates credit risk to the District. The District's credit portfolio is comprised of a number of segments having varying agricultural characteristics. The following table/chart illustrates the aggregate credit portfolio of the District by major commodity segments.

	Percent of Portfolio		
Commodity Group	**2003**	**2002**	**2001**
Poultry	12%	12%	13%
Forestry	10	10	10
Cattle	8	7	7
Grain	7	7	7
Dairy	7	7	6
Rural Home	6	7	10
Nursery/Greenhouse	5	5	4
Swine	4	4	4
Tobacco	3	3	4
Citrus	3	4	4
Cotton	3	3	3
Utilities	3	3	3
Other	29	28	25
Total	100%	100%	100%

The table illustrates that in 2003 commodity concentrations were 5 percent or more in only seven segments. The concentration in these segments is mitigated by non-farm income among the borrowers as demonstrated in the following table, which segregates part-time farm loans into a unique segment.

	Percent of Portfolio		
Commodity Group	**2003**	**2002**	**2001**
Part-time Farmers	46%	45%	44%
Poultry	11	11	12
Dairy	8	7	7
Forestry	4	4	4
Nursery/Greenhouse	4	3	3
Grain	3	5	6
Cattle	3	3	3
Cotton	3	3	3
Swine	3	3	4
Tobacco	3	3	3
Other	12	13	11
Total	100%	100%	100%

The two commodities in which the combined Associations have a concentration of full-time farmers greater than 5 percent are poultry and dairy. The poultry concentration is composed primarily of chicken, turkey, and egg production. The Associations finance contract grower loans and originate many poultry integrator loans. Due to Association commodity and/or borrower exposure limits, these loans are syndicated or participated to AgFirst and/or commercial banks. The financial statements of the integrators are reviewed regularly by the Bank and the Associations and currently reflect the capacity to honor the grower contracts. Production is spread throughout the combined Associations' footprint and credit risk is mitigated somewhat by guarantees. Dairy volume is also spread throughout the combined Associations' footprint. Herd sizes range from less than 100 cows to over 10,000. Associations also manage their credit and concentration risks through participations and with guarantees.

Individual loan exposures totaling $5 million or greater, which represent the commercial and corporate side of agribusiness, comprise approximately 15 percent of Association loan volume. Loans exceeding an Association's delegated lending authority must be pre-approved by AgFirst. As a result, larger agribusiness loans are typically analyzed by AgFirst's commercial lending staff as well as the Associations' own lending staff prior to an Association committing to such loans. Much of the individual loan exposure above $5 million is subsequently sold to other Associations or AgFirst.

Approximately 50 percent of outstanding loan volume is comprised of loans under $500 thousand, and loans less than $100 thousand make up 15 percent of loan volume. This diversification among borrowers is another key component of the Associations' stable credit quality and solid financial performance over time.

AgFirst and each Association maintain an allowance for loan losses determined by its management and is capitalized to serve its unique market. The following table illustrates the risk bearing capacity of the Associations.

	Permanent Capital Ratio	Core Surplus Ratio	Allowance/ Loans
High	25.83%	25.24%	3.50%
Mean	15.12%	11.47%	2.28%
Low	11.78%	8.23%	1.54%

Analysis indicates that an allowance for losses for AgFirst's direct note portfolio is not warranted. Allowance for losses as a percent of participations/syndications and SMMU outstanding was 1.92 percent, 1.58 percent and 1.15 percent in 2003, 2002 and 2001, respectively.

Results of Operations

Net Income

District net income totaled $319,631 for the year ended December 31, 2003, an increase of $7,084 over 2002, while 2002 net income increased $9,306 over 2001. Major components of the changes in net income for the referenced periods are outlined in the following table and discussion.

	Year Ended December 31,	
(dollars in thousands)	**2003**	**2002**
Net income (for prior year)	$ 312,547	$ 303,241
Increase (decrease) due to:		
Total interest income	(44,386)	(135,617)
Total interest expense	67,241	204,343
Net interest income	22,855	68,726
Provision for loan losses	17,110	(4,967)
Noninterest income	(5,519)	8,849
Noninterest expense	(30,687)	(39,708)
Provision for income taxes	3,325	(23,594)
Total increase (decrease) in net income	7,084	9,306
Net income	$ 319,631	$ 312,547

Interest Income

Total interest income for the year ended December 31, 2003 was $860,494, a decrease of $44,386, as compared to the same period of 2002. Total interest income for 2002 was $904,880, a decrease of $135,617 over the same period of 2001. The year-to-year decreases are primarily attributed to the decreasing rate environment seen during these periods; however, increases in average earning assets were significant in offsetting the impact of the rate environment.

The following table illustrates the impact that volume and yield changes had on interest income over these periods.

	Year Ended December 31,	
(dollars in thousands)	**2003-2002**	**2002-2001**
Increase in average earning assets	$ 1,714,316	$ 1,252,647
Average yield (prior year)	5.94%	7.44%
Interest income variance attributed to change in volume	101,845	93,239
Average earning assets (current year)	16,945,882	15,231,566
Increase (decrease) in average yield	(.86%)	(1.50%)
Interest income variance attributed to change in yield	(146,231)	(228,856)
Net change in interest income	$ (44,386)	$ (135,617)

Interest Expense

Total interest expense for the year ended December 31, 2003 was $284,581, a decrease of $67,241, as compared to the same period of 2002. Total interest expense for the year ended December 31, 2002 was $351,822, a decrease of $204,343 over the same period of 2001. The decrease in interest expense is primarily attributed to falling interest rates, offset somewhat by an increase in interest-bearing liabilities to support asset growth.

Prior to the adoption of Statement of Financial Accounting Standard (SFAS) No.150, "Accounting for Certain Financial Instruments with *both Characteristics of Liabilities and Equity,"* dividends on preferred stock were reflected as an adjustment to capital and not as expense. As a result, the issuance of $225,000 of mandatorily redeemable preferred stock in 2001 and $150,000 of perpetual preferred stock in 2003 resulted in a decrease in interest expense, as the proceeds from the stock issuances were used to pay down debt.

With the adoption of SFAS No.150 on July 1, 2003, dividends on mandatorily redeemable preferred stock are required to be prospectively reflected as interest expense. As a result, $9,443, which represents dividends from July 1, 2003 to December 31, 2003 on the $225,000 mandatorily redeemable preferred stock, was reflected as interest expense rather than an adjustment to capital in 2003.

The following table illustrates the impact that volume and rate changes had on interest expense over these periods.

(dollars in thousands)	**Year Ended December 31, 2003-2002**	**2002-2001**
Increase in average interest-bearing liabilities	$ 1,558,036	$ 1,005,336
Average rate (prior year)	2.82%	4.85%
Interest expense variance attributed to change in average interest-bearing liabilities	43,988	48,806
Average interest-bearing liabilities (current year)	14,019,530	12,461,494
Increase (decrease) in average rate	(.79%)	(2.03%)
Interest expense variance attributed to change in rate	(111,229)	(253,149)
Net change in interest expense	$ (67,241)	$ (204,343)

Net Interest Income

Net interest income increased from 2001 to 2002 and from 2002 to 2003 as illustrated by the following table:

Analysis of Net Interest Income

(dollars in thousands)	**2003 Avg. Balance**	**2003 Interest**	**2002 Avg. Balance**	**2002 Interest**	**2001 Avg. Balance**	**2001 Interest**
Loans	$ 13,951,128	$ 801,068	$ 13,283,343	$ 842,022	$ 11,845,091	$ 935,948
Cash & Investments	2,994,754	59,426	1,948,223	62,858	2,133,828	104,549
Total Earning Assets	$ 16,945,882	$ 860,494	$ 15,231,566	$ 904,880	$ 13,978,919	$ 1,040,497
Interest-Bearing Liabilities	$ 14,019,530	$ (284,581)	$ 12,461,494	$ (351,822)	$ 11,456,158	$ (556,165)
Impact of Capital	$ 2,926,352		$ 2,770,072		$ 2,521,756	
NET INTEREST INCOME		$ 575,913		$ 553,058		$ 484,332

	2003 Average Yield	**2002 Average Yield**	**2001 Average Yield**
Yield on Loans	5.74%	6.34%	7.90%
Yield on Cash & Investments	1.98%	3.23%	4.90%
Yield on Earning Assets	5.08%	5.94%	7.44%
Cost of Interest-Bearing Liabilities	2.03%	2.82%	4.85%
Spread	3.05%	3.12%	2.59%
Impact of Capital	.35%	.51%	.88%
Net Interest Income/Avg. Earning Assets	3.40%	3.63%	3.46%

The increase in net interest income from 2001 to 2002 was primarily due to increases in average earning assets, an improvement in spread, and the impact of preferred stock. The District's spread improved primarily due to AgFirst's ability to exercise call options on debt during the decline in interest rates, effectively lowering its cost of funds relative to the assets, which did not prepay as quickly. In 2003, the spread began to return to more normal levels, as asset prepayments began to "catch up" to called debt levels or as the assets and underlying funding matured or repriced in the normal course of business.

The improvement in spread compared to 2001was significantly offset by a decline in the impact of equity funding. Association equity is generally used to fund variable rate loans. As a result, falling interest rates have an adverse impact on Association net interest income approximately equal to the decline in rates times the volume of assets funded with Association equity.

From an Association owner's point-of-view, a decline in interest rates, and the resulting negative impact on net interest income, are not negative events. The funding structure described above essentially makes equity behave like a variable rate investment. When rates go up, the investment earns more. When rates go down, the investment earns less. However, when coupled with the Associations' patronage strategies, this structure can provide some degree of stability to the total shareholder/borrower relationship. Falling rates may depress earnings at the Association level (all other things being equal), which may result in a lower patronage level; however, at the same time, Association members enjoy a lower cost of borrowing.

Provision for Loan Losses

AgFirst and each Association assess risks inherent in their individual portfolios on an ongoing basis and establish an appropriate reserve for loan losses. The aggregate provision for loan losses totaled $8,153 in 2003 compared to $25,263 and $20,296 in 2002 and 2001, respectively. Despite recording a provision in each of the last three years, the ratio of allowance for loan losses to loans outstanding for 2003, 2002 and 2001 was 2.20 percent, 2.25 percent and 2.34 percent, respectively. The year-to-year decline in the allowance ratio is due primarily to loan growth. See Note 2(C), *Summary of Significant Accounting Policies – Loans and Allowance for Loan Losses,* and Note 4, *Loans and Allowance for Loan Losses,* in the notes to the combined financial statements for further information.

Noninterest Income

Noninterest income for the year ended December 31, 2003 was $52,341, a decrease of $5,519, compared to 2002. In 2003, there was a decrease of $13,778 in gains on the sale of rural home loans compared to the prior year. In addition, no interest income was recorded in 2003 for IRS refunds, compared to $2,865 income for these refunds recorded in 2002. These decreases were offset by the $7,358 increase in loan fee income and an increase in realized gains on investments of $1,635 for 2003 compared to 2002.

Despite the high-quality nature of its investment portfolio, AgFirst experienced an unusual loss during 2001 and 2002. A "AAA-rated" security owned by AgFirst was downgraded to "below investment grade" in a single action. With no viable means to divest itself of the security, AgFirst wrote the value down by $7.6 million during 2001. During 2002, an additional $3.4 million was charged off for this investment, bringing its carrying value to zero. Subsequent to writing the security off, recoveries of $1.9 million were realized, resulting in a net chargeoff of $1.5 million during 2002.

For the year ended December 31, 2002, total noninterest income increased $8,849 compared to 2001. The increase from 2001 to 2002 was primarily due to the 2002 gains on the sale of rural home loans and the aforementioned reduction in investment chargeoffs, which were offset by a decrease in interest related to Association IRS refunds.

Noninterest Expense

Noninterest expense for the year ended December 31, 2003 was $299,611, an increase of $30,687 over the same period of 2002. Noninterest expense at December 31, 2002 was $268,924 compared to $229,216 in 2001. The following table illustrates the sources of variance.

(dollars in thousands)	**Year Ended December 31, 2003**	**2002**
Prior Year Noninterest Expense	$ 268,924	$ 229,216
Change in Expense:		
Salaries and employee benefits	21,364	21,206
Occupancy and equipment	755	889
Insurance Fund Premium	12,132	4,051
Other operating expenses	(1,889)	6,788
Intra-System financial assistance expense	(2,319)	1,313
Called debt expense	(1,782)	3,903
Other noninterest expenses	2,426	1,558
Noninterest Expense	$ 299,611	$ 268,924

Salaries and employee benefits have trended up over the two-year period. The increases were largely the result of increasing benefits expense. Weak investment performance and lower discount rates resulted in substantially higher pension expense. Lower discount rates and increasing healthcare trends had a similar impact on post-retirement healthcare expense. These retirement-related expenses represented $14,142, or 66 percent of the $21,364 total increase in salaries and employee benefits for the period ended December 31, 2003. AgFirst, along with other participating Associations, adopted changes to their respective benefits plans during 2002 in an effort to moderate future increases.

Farm Credit System Insurance Corporation (FCSIC) premiums increased in response to growth in System obligations. The FCSIC targets a secure base amount equal to 2 percent of System obligations. Growth throughout the System resulted in the secure base amount decreasing relative to obligations - leading to a premium increase from zero in 2001 to .03 percent of retail loans outstanding in 2002. As a result, expense increased to $4,047 in 2002. In 2003, the premium increased from 0.03 percent to 0.12 percent of retail loans outstanding and resulted in an expense of $16,179.

Intra-System financial assistance decreased $2,319 from 2002 to 2003. This decrease was due to the retirement of several Financial Assistance Corporation bonds. Intra-System financial assistance increased $1,313 from 2001 to 2002. This increase was largely the result of lower interest rates (which increased the present value of the obligations) and the District receiving a higher allocation of expense due to loan growth. See Note 12, *Intra-System Financial Assistance,* in the notes to the combined financial statements for further information.

Other operating expenses decreased $1,889 from 2002 to 2003 and increased $6,788 from 2001 to 2002. The decrease in 2003 primarily resulted from a decrease in purchased services compared to the prior year. During 2002, the District incurred substantial purchased service expense related to a thorough review and revamping of its accounting processes in preparation of implementing new financial systems in the 2003 – 2004 timeframe. Purchased service expense was $10,318 for 2003 compared to $14,202 for 2002.

Called debt expense decreased $1,782 in 2003 and increased $3,903 in 2002. Unamortized concession (debt issuance expense) is amortized over the life of the underlying debt security. When securities are called prior to maturity, any unamortized concession is expensed. Falling interest rates enabled AgFirst to call a substantial amount of debt during 2003, 2002, and 2001, resulting in called debt expense of $11,736, $13,518 and $9,615, respectively.

Provision for Income Taxes

Provision for income taxes decreased $3,325 in 2003 compared to 2002. The decrease is attributable to changes in Association patronage distribution strategies resulting from the formation of holding company structures. See Note 10, *Income Taxes*, for further details.

Liquidity and Funding Sources

AgFirst maintains adequate liquidity to satisfy the District's daily cash needs. In addition to normal cash flow associated with lending operations, AgFirst has two primary sources of liquidity: investments and the issuance of Systemwide debt securities.

Investments, Cash and Cash Equivalents

FCA Regulations provide that a Farm Credit Bank may hold certain eligible investments, in an amount not to exceed 30 percent of its total loans outstanding, to satisfy FCA's liquidity reserve requirement, manage surplus short-term funds, and manage interest rate risk. AgFirst maintains an investment portfolio comprised primarily of short-duration, high-quality investments. The high-quality, short-duration nature of the portfolio guarantees that investments can be converted to cash quickly, without significant risk of loss.

Investment securities and cash equivalents outstanding as of December 31, 2003 for AgFirst totaled $3.30 billion compared to $2.50 billion and $1.92 billion at December 31, 2002 and 2001, respectively. The increase is primarily attributed to efforts by AgFirst to increase its liquidity coverage.

AgFirst's investment portfolio consisted of the following security types as of December 31, 2003.

(dollars in thousands)	2003		2002		2001	
Investment Securities						
Commercial Paper	$ 229,879	7%	$ 259,820	10%	$ 280,576	15%
U.S. Govt. GNMA MBS/CMOs	911,176	28	826,576	33	200,777	11
U.S. Govt. Agency MBS	1,634,415	50	960,268	38	824,791	43
Non-Agency Whole Loans	20,275	1	37,899	2	142,399	7
Commercial MBS	1,717	—	3,236	—	6,514	—
Asset-backed Securities	35,254	1	65,319	3	113,400	6
Corporate Debt	—	—	—	—	94,866	5
Total Investment Securities *	2,832,716	87	2,153,118	86	1,663,323	87
Cash Equivalents						
Fed Funds	108,700	3	75,691	3	40,301	2
Master Notes	109,935	3	117,000	5	187,572	10
Repos	250,000	7	150,000	6	25,000	1
Total Cash Equivalents	468,635	13	342,691	14	252,873	13
Total Investment Portfolio	$ 3,301,351	100%	$ 2,495,809	100%	$ 1,916,196	100%

* *As shown on the Combined Balance Sheet, excluding cash equivalents.*

At December 31, 2003, money market instruments (Commercial Paper and Cash Equivalents of Fed Funds, Master Notes and Repos) represented 20 percent of the portfolio. U.S. Government and Agency-guaranteed mortgage securities made up an additional 78 percent of the portfolio. The remaining 2 percent of the portfolio, while not Government or Agency-guaranteed, consists of highly rated, liquid securities.

AgFirst, in conjunction with the other System Banks, has adopted a liquidity policy that establishes a "minimum coverage" level of 90 days. "Coverage" is defined as the number of days that maturing debt could be funded through the sale of liquid investments and Agency-guaranteed rural home loans. At December 31, 2003, AgFirst's coverage was 134 days.

Systemwide Debt Securities

The primary source of funds for AgFirst is the issuance of Systemwide debt securities through the Federal Farm Credit Banks Funding Corporation. At December 31, 2003, AgFirst had $14.5 billion in total debt outstanding compared to $13.5 billion at December 31, 2002 and $12.1 billion at December 31, 2001. The year-to-year increases were primarily due to the increases in loan volume and investments. Refer to Note 7, *Bonds and Notes,* for additional information related to debt.

Asset/Liability Management

AgFirst adheres to a philosophy that all loans should be priced competitively in the market and that loan rates and spreads should be contractually established at loan closing such that a borrower is not subject to rate changes at the discretion of management or boards of directors. Therefore, all District Association variable rate and adjustable rate loans are indexed to market rates, and fixed rate loans are priced based on market rates at closing. Loan products offered by the Associations include prime-indexed variable rate loans, LIBOR-indexed variable rate loans, one-, three- and five-year Treasury-indexed adjustable rate loans, and fixed rate loans. Variable rate and adjustable rate loans are offered with or without caps. Terms are available for up to 30 years. A variety of repayment options are offered, with the ability to pay on a monthly, quarterly, semi-annual or annual frequency. In addition, "custom" repayment plans may be negotiated to fit a borrower's unique circumstances.

The objective of the AgFirst asset/liability management process is to generate a stable and adequate level of net interest income in any interest rate environment. AgFirst uses a variety of sophisticated analytical techniques to manage the complexities associated with offering numerous loan options. These include interest rate sensitivity gap analysis to monitor the repricing characteristics of AgFirst's interest-earning assets and interest-bearing liabilities and simulation analysis to determine the change in net interest income and in the market value of equity due to changes in interest rates. The following tables represent AgFirst's projected change in net interest income and market value of equity for various rate movements as of December 31, 2003.

Net Interest Income
(dollars in thousands)

Scenarios	Net Interest Income	% Change
+400 BP Shock	$190,310	1.49%
+200 BP Shock	197,386	5.26%
0 BP	187,519	—
-47.5 BP Shock*	192,909	2.87%

Market Value of Equity
(dollars in thousands)

Scenarios	Assets	Liabilities	Equity	% Change
Book Value	$15,688,850	$14,740,861	$947,989	—
+400 BP Shock	14,529,316	13,963,726	565,590	(33.30%)
+200 BP Shock	15,060,006	14,358,528	701,478	(17.28%)
0 BP	15,614,668	14,766,646	848,022	—
-47.5 BP Shock*	15,744,290	14,859,739	884,551	4.31%

* *When the three-month Treasury bill interest rate is less than 4 percent, both the minus 200 and minus 400 basis point shocks are replaced with a downward shock equal to one-half of the three-month Treasury bill rate.*

AgFirst provides each Association with core operating systems and support, including a loan origination system, loan accounting and servicing systems, general ledger, and a human resources/payroll system. With AgFirst providing such systems, the Associations are able to achieve efficiencies ordinarily afforded only to much larger organizations. In addition, having common systems supported by AgFirst provides an opportunity to automate the AgFirst/Association lending process. One of the most significant advantages of this is a match-funding mechanism that automatically creates direct note advances that match the repricing and maturity characteristics of each underlying loan. By employing this system, interest rate risk is significantly reduced at the Associations.

The objective of the AgFirst asset/liability management process is to generate a stable and adequate level of net interest income in any interest rate environment. AgFirst uses a variety of sophisticated analytical techniques to manage the complexities associated with offering numerous loan options. These include interest rate sensitivity gap analysis to monitor the repricing characteristics of AgFirst's interest-earning assets and interest-bearing liabilities and simulation analysis to determine the change in net interest income and in the market value of equity due to changes in interest rates.

The following table sets forth the amounts of AgFirst's interest-earning assets and interest-bearing liabilities outstanding at December 31, 2003. The amount of assets and liabilities shown, which reprice or mature during a particular period, were determined in accordance with the earlier of term-to-repricing or contractual maturity anticipated prepayments, and, in the case of liabilities, the exercise of call options.

Repricing/Maturity Gap Analysis

(dollars in thousands)	Less than or Equal to 1 Year	Greater than 1 Year Less than 5 Years	Greater than or Equal to 5 Years	Total
Short and Intermediate-Term Loans				
Fixed	$ 753,304	$ 311,370	$ 73,265	$ 1,137,939
Variable	3,763,588	—	—	3,763,588
Total Short and Intermediate-Term Loans	4,516,892	311,370	73,265	4,901,527
Long-Term Real Estate Loans				
Fixed	2,836,007	2,912,589	1,492,435	7,241,031
Variable	205,095	26,697	1,001	232,793
Total Long-Term Real Estate Loans	3,041,102	2,939,286	1,493,436	7,473,824
Total Loans	7,557,994	3,250,656	1,566,701	12,375,351
Cash and Investments	2,723,069	439,478	140,114	3,302,661
TOTAL INTEREST EARNING ASSETS	$ 10,281,063	$ 3,690,134	$ 1,706,815	$ 15,678,012
Source of Funds				
Interest Bearing Liabilities	$ 10,430,105	$ 3,897,000	$ 180,000	$ 14,507,105
Preferred Stock	—	—	225,000	225,000
Perpetual Preferred Stock	—	—	150,000	150,000
Interest Rate Swaps	415,000	(415,000)	—	—
Equity	—	—	804,532	804,532
TOTAL SOURCE OF FUNDS	$ 10,845,105	$ 3,482,000	$ 1,359,532	$ 15,686,637
Interest Rate Sensitivity Gap	$ (564,041)	$ 208,134	$ 347,283	
Sensitivity Gap as a % of Total Earning Assets	(3.60%)	1.33%	2.22%	
Cumulative Gap	$ (564,041)	$ (355,907)	$ (8,624)	
Cumulative Gap as a % of Total Earning Assets	(3.60%)	(2.27%)	(.06%)	
Rate Sensitive Assets/Rate Sensitive Liabilities	.95	1.06	1.26	

At December 31, 2003, approximately $1.1 billion of callable bonds were "in the money," resulting in the $564 million liability sensitive position in the first tranche. Stable or falling rates would result in the bonds being called, resulting in further improvement in AgFirst's net interest margin. Rising rates would simply result in the bonds not being called and liability-sensitive position would immediately shift toward an asset-sensitive position, as reflected in the net interest income sensitivity analysis above.

At December 31, 2003, AgFirst had outstanding interest rate swaps with notional amounts totaling $1.166 billion and purchased interest rate caps with notional amounts totaling $1.887 billion. These derivative transactions were executed to reduce interest rate risk and/or reduce funding costs.

AgFirst policy prohibits the use of derivatives for speculative purposes. Refer to Note 17, *Derivative Instruments and Hedging Activities,* in the notes to the combined financial statements for additional information. The following table shows the activity in derivatives during the year ended December 31, 2003.

Disclosures for Derivative Financial Instruments

Notional amounts *(dollars in millions)*	**Receive Fixed**	**Amortizing Floating for Floating**	**Interest Rate Caps**	**Other Derivative Products**	**Total**
Balance at December 31, 2002	$ 193	$ 684	$ 1,762	$ —	$ 2,639
Additions	465	—	100	54	619
Maturities/amortizations	(118)	(58)	(29)	—	(205)
Balance at December 31, 2003	$ 540	$ 626	$ 1,833	$ 54	$ 3,053

Various uses of derivative instruments at December 31, 2003

(dollars in millions)	
Interest rate swaps utilized to create synthetic floating-rate debt to achieve a lower cost of funding	$ 540
Asset/liability management purposes	2,126
Other purposes	387
Total interest rate swaps and caps outstanding	$ 3,053

Preferred Stock

On May 17, 2001, AgFirst issued $225,000 of Class A Mandatorily Redeemable Cumulative Preferred Stock, Series 1, at a par value of $1 thousand per share. This stock is mandatorily redeemable on December 15, 2016 and carries a stated annual dividend rate of (1) 8.393 percent until December 15, 2011, with dividends paid semi-annually on June 15th and December 15th: and (2) thereafter at a floating rate per annum equal to 3 month LIBOR plus 3.615 percent with dividends payable quarterly commencing March 15, 2012. On and after the dividend payment date in December, 2011, the preferred stock will be redeemable in whole or in part at the option of the Bank on any dividend payment date at its par value of $1 thousand per share.

On October 14, 2003, AgFirst issued $150,000 of Class A Perpetual Non-Cumulative Preferred Stock, Series 2 at a par value of $1 thousand per share. Dividends on the stock are non-cumulative and payable on the fifteenth day of June and December in each year, commencing December 15, 2003, at an annual rate equal to 7.30 percent. In the event dividends are not declared on the preferred stock for payment on any dividend payment date, then such dividends shall not cumulate and shall cease to accrue and be payable. On and after the dividend payment date in December 2008, the Bank may, at its option, redeem the preferred stock in whole or in part at any time at the redemption price of $1 thousand per share plus accrued and unpaid dividends for then current dividend period to the date of redemption.

See Note 8, *Mandatorily Redeemable Preferred Stock,* and Note 9, *Protected Borrower Equity and Shareholders' Equity,* of the notes to the combined financial statements of this annual report for more detailed information concerning the preferred stock issuances.

Capital

Total shareholders' equity at December 31, 2003 was $2,561,731 compared to $2,280,556 and $2,280,543 at December 31, 2002 and 2001, respectively. The increase in shareholders' equity is attributed to the issuance of perpetual preferred stock in 2003 and increases in retained earnings.

Poor performance in the District's pension plan investments (which has been significantly impacted by unfavorable stock performance) coupled with declining discount rates used in determining the value of pension obligations led to the recognition of an unfunded pension liability in 2002. Recognition of the unfunded portion of pension obligations as a liability was offset by a charge to accumulated other comprehensive income (loss), which adversely impacted total shareholders' equity. Rising interest rates and/or improvement in investment performance could rapidly eliminate the current under-funded status of the plan. At December 31, 2003, the value of pension investments represented 77 percent of the accumulated benefit obligation.

Capital adequacy is evaluated using a number of regulatory ratios. For all periods presented, AgFirst and the Associations exceeded all minimum regulatory standards. Improvement in the AgFirst Bank-only permanent capital, total surplus, and core surplus ratios from December 31, 2002 to December 31, 2003 was primarily attributed to the accumulation of earnings, offset somewhat by asset growth.

Subsequent to the issuance of the preferred stock, FCA now requires AgFirst to maintain a minimum net collateral ratio of 104 percent compared to the standard regulatory minimum of 103 percent. At December 31, AgFirst's regulatory ratios were:

	Regulatory Minimum	AgFirst Ratio as of 12/31/03	12/31/02	12/31/01
Permanent Capital Ratio	7.00%	25.99%	22.91%	20.70%
Total Surplus Ratio	7.00%	25.79%	22.69%	19.86%
Core Surplus Ratio	3.50%	14.45%	13.20%	10.39%
Collateral Ratio	103.00%	106.94%	105.94%	106.38%

The significant improvement in the permanent capital, total surplus and net collateral ratios from December 31, 2002 to December 31, 2003 was primarily due to the issuance of $150 million of perpetual preferred stock. The stock had no impact on the core surplus ratio, as mandatorily redeemable preferred stock is not considered to be "core surplus."

Additionally, the permanent capital, total surplus, and core surplus ratios from December 31, 2001 to December 31, 2002 were enhanced by the accumulation of earnings, offset somewhat by asset growth.

Unlike the permanent capital, total surplus and core surplus ratios, the net collateral ratio does not incorporate any risk-weighting of assets. The substantial growth in the direct note portfolio, which carries a 20 percent risk weighting in the three capital ratios, more than offset the accumulation of earnings, resulting in the slight decline in the collateral ratio from 2001 to 2002.

Refer to Note 9, *Protected Borrower Equity and Shareholders' Equity*, in the notes to the combined financial statements for additional information.

Legal Proceedings

On the basis of information presently available, management and legal counsel are of the opinion that the ultimate liability, if any, from legal actions pending against the District institutions would be immaterial in relation to the financial position of the District. Refer to Note 15, *Commitments and Contingencies*, in the notes to the combined financial statements for additional information.

Recent Regulatory Matters

On February 24, 2004, the Farm Credit Administration published a final notice in the Federal Register that loan syndication transactions by System institutions to eligible borrowers must be treated as direct loans meeting all statutory and regulatory requirements, rather than as loan participations. In addition, the Farm Credit Administration indicated that since Farm Credit Banks can no longer make direct loans to eligible borrowers, they cannot directly take part in loan syndication transactions to eligible borrowers. Syndication transactions with certain entities whose operations are functionally similar to those of an eligible borrower are not impacted by the final notice. The Farm Credit Administration has included certain transitional provisions with respect to existing loan syndications to eligible borrowers. Future loan syndication transactions under the direct lending authorities will be required to have borrower rights, territorial concurrence and stock requirements attached to them. This development will not impact the ability of certain other System institutions to effectively compete in the syndication market in the future. As of December 31, 2003, loan syndication volume had no material impact on the District's financial position.

Disclosure Required by Farm Credit Administration Regulations

Description of Business

Descriptions of the territory served, persons eligible to borrow, types of lending activities engaged in, financial services offered and related Farm Credit organizations are incorporated herein by reference to Note 1 to the combined 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 to shareholders.

Description of Property

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

Location	Description
1401 Hampton Street	Bank building and adjacent parking
1441 Hampton Street	Vacant
1443 Hampton Street	AgFirst Federal Credit Union
1447 Hampton Street	Leased
1428 Taylor Street	AgFirst training center
1436 Taylor Street	Leased

Legal Proceedings

Information, if any, to be disclosed in this section is incorporated herein by reference to Note 14 to the combined financial statements, *Commitments and Contingencies,* included in this annual report to shareholders.

Description of Capital Structure

Information to be disclosed in this section is incorporated herein by reference to Note 9 to the combined financial statements, *Shareholders' Equity,* included in this annual report to shareholders.

Description of Liabilities

The description of liabilities, contingent liabilities and intrasystem financial assistance rights and obligations to be disclosed in this section is incorporated herein by reference to Notes 2, 6, 7, 11 and 14 to the combined financial statements included in this annual report to shareholders.

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

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

Senior Officers

The following represents certain information regarding the directors and senior officers of the reporting entity.

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

Senior Officer	Position
F. A. (Andy) Lowrey	President and Chief Executive Officer
Thomas S. Welsh	Executive Vice President
William R. Clayton	Senior Vice President

The total amount of compensation earned by the CEO and the highest paid officers as a group (including the CEO) during the years ended December 31, 2003, 2002 and 2001, is as follows:

Name of Individual or Number in Group	Year	Annual Salary	Annual Bonus	Deferred Comp.	Total
F. A. (Andy) Lowrey	2003	$ 377,534	$ 105,710	$ 26,427	$ 509,671
F. A. (Andy) Lowrey	2002	$ 343,213	$ 102,964	$ —	$ 446,177
F. A. (Andy) Lowrey	2001	$ 312,648	$ 78,162	$ —	$ 390,810
5 Officers	2003	$ 1,075,450	$ 202,071	$ 73,444	$ 1,350,965
5 Officers	2002	$ 1,087,203	$ 289,658	$ —	$ 1,376,861
5 Officers	2001	$ 1,001,801	$ 233,532	$ —	$ 1,235,333

In addition to a base salary, senior officers earn additional compensation under the Bank's Corporate Bonus Plan. The plan is designed to motivate employees to exceed specific performance targets related to return on equity (ROE), System CIPA score, FCA rating on quality of management and customer satisfaction rating. Those covered by the plan include all employees. Bonuses are shown in the year earned. Payment of the 2003 bonus was made in the first quarter of 2004.

Disclosure of the total compensation in 2003 to any senior officer, or to any other individual included in the total whose compensation exceeds $50,000, is available to shareholders upon request.

AgFirst Farm Credit Bank Board of Directors

(as of December 31, 2003)

Name	Position	Term of Office
Paul Lemoine	Chairman	December 31, 2003*
E. McDonald Berryman	Vice Chairman	December 31, 2005
William C. Bess, Jr.	Director	December 31, 2005
Dr. Chester D. Black	Director	December 31, 2006
Robert A. Carson	Director	December 31, 2006
R. Tommy Clay, Sr.	Director	December 31, 2004
Don W. Freeman	Director	December 31, 2005
Robert L. Holden, Sr.	Director	December 31, 2006
Paul M. House	Director	December 31, 2003*
Thomas W. Kelly	Director	December 31, 2004
Richard Kriebel	Director	December 31, 2003*
M. Wayne Lambertson	Director	December 31, 2005
F. Merrel Lust	Director	December 31, 2005
Eugene W. Merritt, Jr.	Director	December 31, 2006
Dale W. Player	Director	December 31, 2003*
J. Dan Raines, Jr.	Director	December 31, 2005
Walter L. Schmidlen, Jr.	Director	December 31, 2004
Robert G. Sexton	Director	December 31, 2003*
Robert E. Strayhorn	Director	December 31, 2004

* *Each has been re-elected with new 4-year term ending 12/31/07.*

Paul Lemoine, Chairman of the Board, is a cattle and row crop farmer from Plaucheville, Louisiana. He is active in a number of organizations related to farming, and is employed as a crop sales consultant with Agriliance Chemical Co. He is a member of the Louisiana Cattlemen's Association and the Avoyelles Parish Farm Bureau. During 2003, he served 27 days at AgFirst board meetings and 19 days at other official board functions, and was paid $25,769 in compensation.

E. McDonald Berryman, Vice Chairman of the Board, is a farmer from Elberon, Virginia and is president of Beechland Farms, Inc., a family-owned and operated farm in Surry County, Virginia. His operations consist of 4,000 acres of row crops including peanuts, corn, wheat, soybeans and cotton, and also 1,000 acres of growing timber. He served as past president of Peanut Farmers LLC and is a member of the Surry County Farm Bureau. During 2003, he served 27 days at AgFirst board meetings and 17 days at other official board functions, and was paid $25,769 in compensation.

William C. Bess, Jr., from Lincolnton, North Carolina, is co-owner of Farmers & Builders and Supply Co. and has brood cow operations. He serves as a director of Carolina Farm Credit, ACA and is a member of the national Farm Credit Council Board. During 2003, he served 27 days at AgFirst board meetings and 14 days at other official board functions, and was paid $25,769 in compensation.

Dr. Chester D. Black of Raleigh, North Carolina, serves as the board's outside director. Dr. Black previously served as director of the North Carolina Agriculture Extension Service at North Carolina State University. During 2003, he served 27 days at AgFirst board meetings and 14 days at other official board functions, and was paid $25,769 in compensation.

Robert A. Carson, a row crop farmer in the Mississippi Delta, is active in a number of agricultural organizations. He is a director of the Delta Council and a member of the national Farm Credit Council Board. During 2003, he served 26 days at AgFirst board meetings and 10 days at other official board functions, and was paid $25,769 in compensation.

R. Tommy Clay, Sr., a graduate of the University of Florida, operates a cattle ranch in Putnam County, Florida, and is also involved in real estate development. For more than three decades he has served as a director of the Putnam County Fair and the Rodeheaver Boys Ranch. During 2003, he served 27 days at AgFirst board meetings and 10 days at other official board functions, and was paid $25,769 in compensation.

Don W. Freeman is a farmer-rancher from Lowndesboro, Alabama. He is a member of Lowndes County Alabama Farmers Federation and Cattlemen's Association, and is past president of the Alabama Chapter of the American Society of Farm Managers and Rural Appraisers. During 2003, he served 27 days at AgFirst board meetings and 17 days at other official board functions, and was paid $25,769 in compensation.

Robert L. Holden, Sr. is co-owner and operator of a dairy, a 900-acre row-crop farm, and a 200,000 broiler operation in Whigham, Georgia. He is a director of the Southwest Georgia Farm Credit, ACA, Georgia Milk Producers, and Grady County Farm Bureau. During 2003, he served 24 days at AgFirst board meetings and 13 days at other official board functions, and was paid $25,769 in compensation.

Paul M. House is from Nokesville, Virginia, where he grows corn, soybeans, wheat, hay and turf grass. He also operates a dairy. He serves as a director of the Farm Credit of the Virginias, ACA. During 2003, he served 27 days at AgFirst board meetings and 12 days at other official board functions, and was paid $25,769 in compensation.

Thomas W. Kelly, from Tyrone, Pennsylvania, is owner-operator of a dairy and crop farm. The dairy herd consists of registered Holsteins whose genetics are merchandized. Major crops include corn, alfalfa, soybeans and seed barley. He currently serves on the board of AgChoice Farm Credit, ACA. During 2003, he served 27 days at AgFirst board meetings and 12 days at other official board functions, and was paid $25,769 in compensation.

Richard Kriebel is a contract crop farmer from Benton, Pennsylvania, raising contract forage and grain. His crops consist of 540 owned-and-leased acres (235 acres of corn and 305 acres of hay). He is a director of AgChoice Farm Credit, ACA, and a former member of the Columbia County ASCS, Columbia County Extension and the Columbia County Planning Commission. During 2003, he served 27 days at AgFirst board meetings and 13 days at other official board functions, and was paid $25,769 in compensation.

M. Wayne Lambertson of Pokomoke City, Maryland, owns and operates a 2,700-acre farm of corn, soybeans, and wheat, and a 300,000 capacity broiler operation. He currently serves on the MidAtlantic Farm Credit, ACA board of directors and the board of the Delmarva Poultry Industry DPI, a trade organization. He also serves on the board of the national Farm Credit Council. During 2003, he served 27 days at AgFirst board meetings and 12 days at other official board functions, and was paid $25,769 in compensation.

F. Merrel Lust is from Marion, Ohio, and grows corn, soybeans, and wheat on a 5,900-acre operation in partnership with his twin brother, son and nephew. He currently serves as a member of the board of Ag Credit ACA. During 2003, he served 24 days at AgFirst board meetings and 12 days at other official board functions, and was paid $25,769 in compensation.

Eugene W. Merritt, Jr., from Easley, South Carolina, is co-owner of an ornamental tree farm and is a landscape contractor. The Clemson University graduate also operates a 400-acre timber and grass farm. He serves on the board of Palmetto Farm Credit, ACA. During 2003, he served 27 days at AgFirst board meetings and 12 days at other official board functions, and was paid $25,769 in compensation.

Dale W. Player is co-owner of a 1,850-acre row crop operation, with cotton being the primary crop. He is a director of Pee Dee Farm Credit, ACA, member of the South Carolina Cotton Board of Directors, and director of the Carolinas Cotton Cooperative. During 2003, he served 27 days at AgFirst board meetings and 12 days at other official board functions, and was paid $25,769 in compensation.

J. Dan Raines, Jr. is a farmer from Ashburn, Georgia. His farming operations include beef cattle, registered Angus cattle and timber. He is a graduate of the University of Georgia, is a director on the board of AgGeorgia Farm Credit, ACA and the Federal Agricultural Mortgage Corporation (Farmer Mac). During 2003, he served 27 days at AgFirst board meetings and 19 days at other official board functions, and was paid $25,769 in compensation.

Walter L. Schmidlen, Jr., from Elkins, West Virginia, is a dairy and beef farmer. He is owner and operator of a farm machinery business and grows hay and corn on a 700-acre farm. He presently serves on the board of the Farm Credit of the Virginias, ACA, and was a former director of Southern States Cooperative and Sire Power. During 2003, he served 27 days at AgFirst board meetings and 13 days at other official board functions, and was paid $25,769 in compensation.

Robert G. Sexton is from Vero Beach, Florida. He is President of Oslo Citrus Growers Association and co-owner of Orchid Island Juice Company. He serves as a director of Farm Credit of South Florida, ACA, Florida Citrus Packers, Indian River Citrus League, Highland Exchange Service Co-op and McArthur Management Company. In addition, he is a member of the Indian River Farm Bureau. During 2003, he served 23 days at AgFirst board meetings and 9 days at other official board functions, and was paid $25,769 in compensation.

Robert E. Strayhorn is a farmer from Chapel Hill, North Carolina. His farming operations include brood cows, feeder calves, timber and row crops. He serves as a director on the board of Carolina Farm Credit, ACA, chairman of the Seven County Junior Livestock Show and Sale Committee, and is active in the Orange County Farm Bureau. During 2003, he served 23 days at AgFirst board meetings and 12 days at other official board functions, and was paid $25,769 in compensation.

Compensation of Directors

Directors 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 upon request.

The aggregate amount of reimbursement for travel, subsistence and other related expenses for all directors as a group was $181,020 for 2003, $182,624 for 2002, and $185,267 for 2001. Subject to approval by the board, AgFirst allows directors to attend other meetings, committee meetings, or special assignments in addition to service at AgFirst board meetings. Total compensation paid to directors as a group was $489,611 during 2003.

Transactions with Senior Officers and Directors

The reporting entity's policies on loans to and transactions with its officers and directors, to be disclosed in this section are incorporated herein by reference to Note 13 to the combined financial statements, *Related Party Transactions,* included in this annual report to shareholders.

Involvement in Certain Legal Proceedings

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

Relationship with Independent Public Accountants

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

Combined Financial Statements

The combined financial statements, together with the report thereon of PricewaterhouseCoopers LLP, dated February 24, 2004, and the Report of Management, which appear in this annual report to shareholders are incorporated herein by reference.

Borrower Information Regulations

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

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

Shareholder Investment

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

Report of Independent Auditors

PRICEWATERHOUSECOOPERS

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

Report of Independent Auditors

February 24, 2004

To the Board of Directors and Shareholders
of AgFirst Farm Credit Bank and District Associations

We have audited the accompanying combined balance sheets of AgFirst Farm Credit Bank and District Associations as of December 31, 2003, 2002, and 2001, and the related combined statements of income, of changes in shareholders' equity, and of cash flows for each of the three years in the period ended December 31, 2003. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of AgFirst Farm Credit Bank and District Associations at December 31, 2003, 2002 and 2001, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2003 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2, the Bank changed its method of accounting for its mandatorily redeemable preferred stock effective July 1, 2003.

PricewaterhouseCoopers LLP

Combined Balance Sheets

(dollars in thousands)	**December 31, 2003**	**December 31, 2002**	**December 31, 2001**
Assets			
Cash and cash equivalents	$ 494,339	$ 444,457	$ 339,541
Investment securities	2,832,716	2,153,118	1,663,323
Loans	14,369,690	13,823,089	12,877,889
Less: allowance for loan losses	316,735	311,180	301,615
Net loans	14,052,955	13,511,909	12,576,274
Accrued interest receivable	122,007	131,638	143,685
Investments in other Farm Credit System institutions	19,157	18,736	19,596
Premises and equipment, net	86,914	77,361	75,106
Other property owned	2,253	4,828	5,925
Deferred tax assets, net	13,303	13,761	23,981
Other assets	72,273	71,193	114,262
Total assets	$17,695,917	$16,427,001	$14,961,693
Liabilities			
Bonds and notes	$14,507,105	$13,538,536	$12,115,709
Mandatorily redeemable preferred stock (Note 8)	225,000	—	—
Accrued interest and dividend payable	52,025	43,733	60,443
Dividends and patronage refunds payable	68,885	64,180	69,088
Postretirement benefits other than pensions	79,249	67,193	60,315
Minimum pension liability	52,519	61,822	—
Other liabilities	149,403	145,142	149,756
Total liabilities	15,134,186	13,920,606	12,455,311
Commitments and contingencies (Note 15)			
Mandatorily redeemable preferred stock (Note 8)	—	225,839	225,839
Shareholders' Equity			
Perpetual preferred stock (Note 9)	150,000	—	—
Protected borrower equity	12,453	15,486	19,261
Capital stock and participation certificates	128,099	124,541	127,271
Retained earnings			
Allocated	792,168	756,525	733,378
Unallocated	1,587,934	1,494,659	1,393,592
Accumulated other comprehensive income (loss)	(108,923)	(110,655)	7,041
Total shareholders' equity	2,561,731	2,280,556	2,280,543
Total liabilities and equity	$17,695,917	$16,427,001	$14,961,693

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

Combined Statements of Income

(dollars in thousands)	For the year ended December 31, 2003	2002	2001
Interest Income			
Investment securities and other	$ 59,426	$ 62,858	$ 104,549
Loans	801,068	842,022	935,948
Total interest income	860,494	904,880	1,040,497
Interest Expense	284,581	351,822	556,165
Net interest income	575,913	553,058	484,332
Provision for loan losses	8,153	25,263	20,296
Net interest income after provision for loan losses	567,760	527,795	464,036
Noninterest Income			
Loan fees	38,926	31,568	29,530
Fees for financially related services	6,249	5,077	6,052
Realized gains (losses) on investments, net	247	(1,388)	(4,798)
Interest related to IRS refunds (Note 10)	—	2,865	12,094
Gains on sale of rural home loans	523	14,301	—
Other noninterest income	6,396	5,437	6,133
Total noninterest income	52,341	57,860	49,011
Noninterest Expenses			
Salaries and employee benefits	173,843	152,479	131,273
Occupancy and equipment	24,503	23,748	22,859
Insurance Fund premium	16,179	4,047	(4)
Other operating expenses	56,031	57,920	51,132
Intra-System financial assistance expenses	13,162	15,481	14,168
Called debt expense	11,736	13,518	9,615
Impairment of servicing assets	2,600	—	—
Other noninterest expenses	1,557	1,731	173
Total noninterest expenses	299,611	268,924	229,216
Income before income taxes	320,490	316,731	283,831
Provision (benefit) for income taxes	859	4,184	(19,410)
Net income	$ 319,631	$ 312,547	$ 303,241

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

Combined Statements of Changes in Shareholders' Equity

(dollars in thousands)	Perpetual Preferred Stock	Protected Borrower Equity	Capital Stock and Participation Certificates	Retained Earnings Allocated	Retained Earnings Unallocated	Accumulated Other Comprehensive Income	Total Shareholders' Equity
Balance at December 31, 2000	$ —	$ 23,634	$ 132,856	$ 704,010	$ 1,302,163	$ (1,450)	$ 2,161,213
Comprehensive income							
Cumulative effect of a change in accounting for derivatives						(1,037)	(1,037)
Net income					303,241		303,241
Unrealized gains (losses) on investments available for sale, net of reclassification adjustments of $(4,798)						12,588	12,588
Change in fair value of derivative instruments						(3,060)	(3,060)
Total comprehensive income							311,732
Protected borrower equity retired		(4,373)					(4,373)
Capital stock/participation certificates issued/retired, net			(5,859)				(5,859)
Dividends declared/paid			274		(1,861)		(1,587)
Mandatorily redeemable preferred stock dividends accrued					(11,751)		(11,751)
Patronage distribution							
Cash					(69,034)		(69,034)
Qualified allocated surplus				75,336	(75,336)		—
Nonqualified allocated surplus				29,946	(29,946)		—
Nonqualified retained surplus				21,165	(21,165)		—
Retained earnings retired				(98,923)			(98,923)
Patronage distribution adjustment				1,844	(2,719)		(875)
Balance at December 31, 2001	—	19,261	127,271	733,378	1,393,592	7,041	2,280,543
Comprehensive income							
Net income					312,547		312,547
Unrealized gains (losses) on investments available for sale, net of reclassification adjustments of $(1,388)						6,856	6,856
Change in fair value of derivative instruments						(16,782)	(16,782)
Minimum pension liability adjustment						(107,770)	(107,770)
Total comprehensive income							194,851
Protected borrower equity retired		(3,775)					(3,775)
Capital stock/participation certificates issued/retired, net			(2,820)				(2,820)
Dividends declared/paid			90		(1,971)		(1,881)
Mandatorily redeemable preferred stock dividends accrued					(18,887)		(18,887)
Patronage distribution							
Cash					(62,965)		(62,965)
Qualified allocated surplus				50,936	(50,936)		—
Nonqualified allocated surplus				42,261	(42,261)		—
Nonqualified retained surplus				32,402	(32,402)		—
Retained earnings retired				(105,217)			(105,217)
Patronage distribution adjustment				2,765	(2,058)		707
Balance at December 31, 2002	—	15,486	124,541	756,525	1,494,659	(110,655)	2,280,556
Comprehensive income							
Net income					319,631		319,631
Unrealized gains (losses) on investments available for sale, net of reclassification adjustments of $247						(9,480)	(9,480)
Change in fair value of derivative instruments						2,116	2,116
Minimum pension liability adjustment						9,096	9,096
Total comprehensive income							321,363
Perpetual preferred stock issued	150,000						150,000
Protected borrower equity retired		(3,033)					(3,033)
Capital stock/participation certificates issued/retired, net			3,474				3,474
Dividends declared/paid			84		(2,242)		(2,158)
Perpetual preferred stock dividends paid					(1,851)		(1,851)
Mandatorily redeemable preferred stock dividends accrued					(9,443)		(9,443)
Patronage distribution							
Cash					(65,634)		(65,634)
Qualified allocated surplus				46,636	(46,636)		—
Nonqualified allocated surplus				47,154	(47,154)		—
Nonqualified retained surplus				48,391	(48,391)		—
Retained earnings retired				(111,175)			(111,175)
Patronage distribution adjustment				4,637	(5,005)		(368)
Balance at December 31, 2003	$ 150,000	$ 12,453	$ 128,099	$ 792,168	$ 1,587,934	$ (108,923)	$ 2,561,731

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

Combined Statements of Cash Flows

(dollars in thousands)	For the year ended December 31, 2003	2002	2001
Cash flows from operating activities:			
Net income	$ 319,631	$ 312,547	$ 303,241
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation on premises and equipment	12,624	11,875	10,898
Provision for loan losses	8,153	25,263	20,296
(Gains) losses on other property owned, net	193	(377)	(387)
Realized (gains) losses on investments, net	(247)	1,388	4,798
Realized (gains) losses on mortgage loans held for sale	(523)	(14,301)	—
Proceeds from sale of mortgage loans held for sale	754,486	806,473	—
Originations of mortgage loans held for sale (net of principal repayment)	(667,196)	(531,977)	(346,122)
Changes in operating assets and liabilities:			
(Increase) decrease in accrued interest receivable	9,631	12,047	35,443
(Increase) decrease in investments in other Farm Credit System institutions	(421)	860	(1,321)
(Increase) decrease in deferred tax assets, net	458	7,471	7,730
(Increase) decrease in other assets	1,302	45,818	(32,478)
Increase (decrease) in accrued interest and dividend payable	8,292	(16,710)	(60,265)
Increase (decrease) in postretirement benefits other than pensions	12,056	6,878	6,060
Increase (decrease) in minimum pension liability	(9,303)	61,822	—
Increase (decrease) in other liabilities	13,884	(121,729)	28,064
Total adjustments	143,389	294,801	(327,284)
Net cash provided by (used in) operating activities	463,020	607,348	(24,043)
Cash flows from investing activities:			
Investment securities purchased	(4,826,206)	(3,040,275)	(2,346,707)
Investment securities sold or matured	4,137,375	2,555,948	2,691,260
Net (increase) decrease in loans	(642,494)	(1,222,635)	(1,444,725)
Purchase of premises and equipment, net	(22,177)	(14,130)	(17,449)
Proceeds from sale of other property owned	6,966	2,928	5,370
Net cash used in investing activities	(1,346,536)	(1,718,164)	(1,112,251)
Cash flows from financing activities:			
Bonds and notes issued	57,612,055	49,737,367	44,526,761
Bonds and notes retired	(56,641,370)	(48,331,322)	(43,429,706)
Perpetual preferred stock issued	150,000	—	—
Mandatorily redeemable preferred stock issued	—	—	225,000
Protected borrower equity retired	(3,033)	(3,775)	(4,373)
Capital stock and participation certificates issued/retired, net	3,474	(2,820)	(5,859)
Patronage refunds and dividends paid	(64,420)	(59,614)	(52,357)
Dividends paid on perpetual preferred stock	(1,851)	—	—
Dividends paid on mandatorily redeemable preferred stock	(10,282)	(18,887)	(10,912)
Retained earnings retired	(111,175)	(105,217)	(98,923)
Net cash provided by financing activities	933,398	1,215,732	1,149,631
Net increase (decrease) in cash and cash equivalents	49,882	104,916	13,337
Cash and cash equivalents, beginning of period	444,457	339,541	326,204
Cash and cash equivalents, end of period	$ 494,339	$ 444,457	$ 339,541
Supplemental schedule of non-cash investing and financing activities:			
Financed sales of other property owned	$ 671	$ 3,553	$ 955
Loans transferred to other property owned	4,817	5,095	5,541
Patronage refund and dividends payable	78,074	83,733	81,533
Change in unrealized gains (losses) on investments	(9,480)	6,856	12,588
Change in fair value of derivative instruments	2,116	(16,782)	(3,060)
Non-cash changes related to hedging activities:			
Decrease (increase) in loans	$ (1,894)	$ (1,024)	$ 3,199
Increase (decrease) in bonds and notes	1,082	(8,478)	9,610
Decrease (increase) in other assets	(1,564)	9,328	(11,248)
Increase (decrease) in other liabilities	(3,107)	561	5,734
Supplemental information:			
Interest paid	$ 276,289	$ 368,532	$ 616,430
Taxes paid, net	2,716	4,652	1,198
Federal tax refunds related to long-term lending operations (Note 10)	901	5,834	34,003

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

Notes to Combined Financial Statements

(dollars in thousands, except as noted)

Note 1 — Organization and Operations

A. **Organization:** AgFirst Farm Credit Bank (AgFirst or the Bank) is one of the banks of the Farm Credit System (the System), a nationwide system of cooperatively owned banks (the banks) and associations, established by Acts of Congress and is subject to the provisions of the Farm Credit Act of 1971, as amended (the Farm Credit Act).

The nation is currently served by four Farm Credit Banks (FCBs), each of which has specific lending authorities within its chartered territory, and one Agricultural Credit Bank (ACB), which has nationwide lending authorities. The ACB also has lending authorities of an FCB within its chartered territories. AgFirst is chartered to service the states of Pennsylvania, Delaware, Maryland, Virginia, West Virginia, North Carolina, South Carolina, Georgia, Florida, Alabama, Mississippi, the Commonwealth of Puerto Rico and portions of the states of Ohio, Tennessee, Kentucky and Louisiana.

Each FCB and the ACB serves one or more Production Credit Associations (PCAs) that originate and service short- and intermediate-term loans, Federal Land Credit Associations (FLCAs) that originate and service long-term real estate mortgage loans and/or Agricultural Credit Associations (ACAs) that originate both long-term and short- and intermediate-term loans. PCAs, FLCAs and ACAs are collectively referred to as Associations. AgFirst and its related associations (District Associations) are collectively referred to as the District. The District Associations and certain other financing institutions (OFIs) jointly own virtually all of AgFirst's stock. As of December 31, 2003, the District consisted of the Bank and twenty-four District ACAs. Twenty-two District Associations have restructured as holding companies, which include twenty-two FLCA and twenty-two PCA subsidiaries.

Effective January 1, 2004, two District ACAs merged resulting in a total of twenty-three ACAs.

Each FCB and the ACB is responsible for supervising the activities of the Associations within its district. The FCBs and/or Associations make loans to or for the benefit of eligible borrowers/shareholders for qualified purposes. All District Associations borrow funds from the Bank. Funds for the FCBs and the ACB are raised principally through the sale of consolidated Systemwide bonds and notes to the public.

The Farm Credit Administration (FCA) is delegated authority by Congress to regulate AgFirst and District Associations. The activities of AgFirst and District Associations are examined by the FCA and certain actions by these entities are subject to the FCA's prior approval.

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

B. **Operations:** The Farm Credit Act sets forth the types of authorized lending activity, persons eligible to borrow and financial services which can be offered by AgFirst and the District Associations.

AgFirst and/or the District Associations are 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. AgFirst may also lend to financial institutions engaged in lending to eligible borrowers. The District Associations may also serve as an intermediary in offering credit life insurance and multi-peril crop insurance, and in providing additional services to borrowers.

The District Associations borrow from AgFirst and in turn may originate and service both long-term real estate mortgage and short- and intermediate-term loans to their members. As noted above, as of January 1, 2003, twenty-two ACAs have reorganized into parent-subsidiary structures and operate their long-term mortgage activities through FLCA subsidiaries and their short- and intermediate-term lending activities through PCA subsidiaries or the ACA.

AgFirst owns the Farm Credit Finance Corporation of Puerto Rico (the Finance Corporation). The Finance Corporation currently borrows funds from AgFirst and eligible funds from qualified companies doing business in Puerto Rico under Section 2(j) of the Puerto Rico Tax Incentive Act of 1987, as amended, or the Puerto Rico Tax Incentive Act of 1998, including corporations that have elections under Section 936 and 30(A) of the Internal Revenue Code of 1986, as amended (Code), and may borrow funds from other sources within or outside Puerto Rico in the future. The funds so borrowed are primarily used to acquire from AgFirst the note receivable from Puerto Rico Farm Credit, ACA, and to acquire eligible loans originated by other System institutions. Savings in interest costs are, in part, passed along to borrowers in Puerto Rico who meet certain eligibility requirements.

AgFirst, in conjunction with other System banks, jointly owns service organizations, which were created to provide a variety of services for the System:

❖ *Federal Farm Credit Banks Funding Corporation (Funding Corporation)* — provides for the issuance, marketing and processing of Systemwide debt securities using a network of investment dealers and dealer banks. The Funding Corporation also provides financial management and reporting services.

❖ *FCS Building Association* — leases premises and equipment to the FCA, as required by the Farm Credit Act.

❖ *Farm Credit System Association Captive Insurance Company* — a reciprocal insurer that provides insurance services to its member organizations.

❖ *Farm Credit Leasing Services Corporation* — provides a variety of leasing services for agricultural–related equipment and facilities. See Note 15.

These investments are accounted for using the cost method. In addition, the *Farm Credit Council* acts as a full-service federated trade association which represents the System before Congress, the Executive Branch and others, and provides support services to System institutions on a fee basis.

Note 2 — Summary of Significant Accounting Policies

The accounting and reporting policies of the District conform to accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry. The preparation of combined financial statements in conformity with GAAP requires the managements of AgFirst and District Associations to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ from those estimates. 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 financial statement presentation.

The accompanying combined financial statements include the accounts of AgFirst (including the Finance Corporation) and the District Associations, and reflect the investments in and allocated earnings of the service organizations in which AgFirst has partial ownership interests. All significant transactions and balances between AgFirst and District Associations have been eliminated in combination.

A. **Cash and Cash Equivalents:** Cash, as included in the financial statements of cash flow, represents cash on hand and deposits at banks.

B. **Investment Securities:** The District, 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 District's investments may not necessarily be held to maturity and accordingly have been classified as available for sale and reported at fair value. The fair values of the related hedges are reported in other assets or other liabilities in the Combined Balance Sheets. Changes in the fair value of investments classified as available for sale and of the related hedges are reflected as direct charges or credits to shareholders' equity. Realized gains and losses are determined using the specific identification method and are recognized in current operations.

The District 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.

C. **Loans and Allowance for Loan Losses:** Long-term real estate mortgage loans generally have original maturities ranging from five to thirty years. Substantially all short- and intermediate-term loans for agricultural production or operating purposes have maturities of ten years or less. Loans are carried at their principal amount outstanding less unearned income adjusted for SFAS No. 133 valuation adjustments. Interest on loans is accrued and credited to interest income based upon the principal amount outstanding.

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.

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

When loans are in nonaccrual status, payments received in cash may be 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 chargeoff 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 chargeoffs have been recovered, the ability of the borrower to fulfill the contractual repayment terms is fully expected and the loan is not classified "doubtful" or "loss."

In cases where a borrower experiences financial difficulties and AgFirst or 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.

Statement of Financial Accounting Standards No. 91 (SFAS No. 91), *"Accounting for Nonrefundable Fees and Costs Associated with Originating and Acquiring Loans and Initial Direct Costs of Leases,"* requires loan origination fees and direct loan origination costs, if material, to be capitalized and the net fee or cost to be amortized over the life of the related loan as an adjustment to yield. SFAS No. 91 has not been implemented by certain District Associations or by AgFirst because the effects are considered by management to not be material to their individual financial positions or results of operations or to the combined financial position or results of operations of the District.

The allowance for loan losses is maintained at a level considered adequate by management to provide for losses inherent in the loan portfolio. The allowance is based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including economic conditions, loan portfolio composition and prior loan loss experience. 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.

Significant individual loans are evaluated based upon 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, geographic, industry and other factors

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

The allowance for loan losses is based upon estimates, appraisals and evaluations of loans which, by their nature, contain elements of uncertainty and imprecision. The possibility exists that changes in the economy and its impact on borrower repayment capacity will cause these estimates, appraisals and evaluations to change.

Changes in factors contributing to 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.

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

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

F. **Other Assets and Other Liabilities:** Direct expenses incurred in issuing debt are deferred and amortized using the straight-line method (which approximates the interest method) over the term of the related indebtedness and term of the preferred stock.

Derivative financial instruments are included on the balance sheet, at fair value, as either other assets or other liabilities.

G. **Advanced Conditional Payments:** The District Associations are 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 (ACPs), the advanced conditional payments are netted against the borrower's related loan balance. ACPs which are held by the District but cannot be used to reduce outstanding loans balances, except at the direction of the borrower, are classified as other liabilities in the combined balance sheets. ACPs are not insured, and interest is generally paid by the associations on such balances. The total outstanding gross balances of advance conditional payments, both netted against loans and classified as other liabilities at December 31, 2003, 2002 and 2001 were $154 million, $153 million and $148 million, respectively.

H. **Employee Benefit Plans:** The employees of the District participate in one of three defined benefit retirement plans within the District. The "Projected Unit Credit" actuarial method is used for financial reporting purposes, and the "Entry-Age Normal Cost" method is used for funding purposes. As a result of the funded status of the District's defined benefit retirement plan (the Plan) at the measurement date (September 30), the District may record a minimum liability, an intangible asset relating to unrecognized prior service cost and an adjustment to other comprehensive income (loss). The adjustment to other comprehensive income (loss) would be net of deferred taxes, if significant. For participants hired before January 1, 2003, benefits are determined based on a final average pay formula. For those participants hired on or after January 1, 2003, benefits are determined using a cash balance formula.

District employees are eligible to participate in the thrift/deferred compensation plan (Thrift Plan), which qualifies as a 401(k) plan as defined by Internal Revenue Code. The Thrift Plan requires AgFirst and Associations to match a percentage 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. Thrift Plan costs are expensed as funded.

In addition to providing pension benefits, the Bank and District Association provides certain health care and life insurance benefits for the retired employees (other postretirement benefits). Substantially all employees may become eligible for these benefits it they reach normal retirement age while working for the Bank or District Association.

I. **Income Taxes:** AgFirst and FLCA subsidiaries of ACA parent companies are exempt from Federal and other income taxes as provided in the Farm Credit Act. The Finance Corporation and Puerto Rico Farm Credit, ACA receive a partial credit for taxes payable on Puerto Rico sourced income in accordance with Section 936 of the Internal Revenue Code of 1986, as amended. See Note 1(B) — *Operations*. In addition, an ACA may reorganize and create taxable PCA and non-taxable FLCA subsidiaries.

Twenty-two of the twenty-four District Associations have formed tax exempt FLCA subsidiaries as described in Note 1.

The ACAs provide for Federal and certain other income taxes and are eligible to operate as cooperatives that qualify for tax treatment under Subchapter T of the Internal Revenue Code. Most District Associations operate as cooperatives under Subchapter T and can deduct from taxable income, amounts distributed as qualified patronage refunds to borrowers in the form of cash, stock or allocated retained earnings. Amounts distributed as nonqualified patronage refunds are tax deductible by the ACAs only when redeemed. Income taxes are provided only on the earnings not distributed or not expected to be distributed as qualified patronage refunds or those earnings that are exempt from tax due to the long-term lending exemption.

District Associations recognize 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. District Associations may provide a valuation allowance for deferred tax assets to the extent that it is more likely than not that they will not be realized.

At December 31, 2003, deferred income taxes have not been provided by certain District Associations on approximately $127 million of patronage refunds received prior to January 1, 1993. Such refunds, distributed in the form of stock, are subject to tax only upon conversion to cash. Under GAAP, deferred taxes must be provided on all patronage refunds made to taxable District Associations after December 31, 1992, except to the extent that a portion of these amounts will be distributed in the form of patronage to District Association members.

No deferred taxes have been provided on AgFirst's unallocated earnings. AgFirst currently has no plans to distribute unallocated AgFirst earnings and does not contemplate circumstances, which, if distributions were made, would result in taxes being paid at the Association level.

J. **Derivative Instruments and Hedging Activity:** The Bank is party to derivative financial instruments, primarily interest rate swaps, which are principally used to manage interest rate risk on assets, liabilities and anticipated transactions. Derivatives are recorded on the balance sheet as assets and liabilities, measured at fair value.

Changes in the fair value of a derivative are recorded in current period earnings or accumulated other comprehensive income (loss) depending on the use of the derivative and whether it qualifies for hedge accounting. For fair-value hedge transactions, which hedge changes in the fair value of assets, liabilities, or firm commitments, changes in the fair value of the derivative will generally be offset by changes in the hedged item's fair value. For cash-flow hedge transactions, which hedge the variability of future cash flows related to a variable-rate asset, liability, or a forecasted transaction, changes in the fair value of the derivative will generally be deferred and reported in accumulated other comprehensive income (loss). The gains and losses on the derivative that are deferred and reported in accumulated other comprehensive income (loss) will be reclassified as earnings in the periods in which earnings are impacted by the variability of the cash flows of the hedged item. The ineffective portion of all hedges is recorded in current period earnings. For derivatives not designated as a hedging instrument, the related change in fair value is recorded in current period earnings.

The Bank formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives that are designated as fair value or cash flow hedges to (1) specific assets or liabilities on the balance sheet or (2) firm commitments or forecasted transactions. The Bank also formally assesses (both at the hedge's inception and on an ongoing basis) whether the derivatives that are used in hedging transactions have been highly effective in offsetting changes in the fair value or cash flows of hedged items and whether those derivatives may be expected to remain highly effective in future periods. The Bank uses regression analysis (or other statistical analysis) to assess the effectiveness of its hedges. The Bank discontinues hedge accounting prospectively when the Bank determines that a hedge has not been or is not expected to be effective as a hedge. For cash flow hedges, any remaining accumulated other comprehensive income (loss) would be amortized into earnings over the remaining life of the original hedged item. For fair value hedges, changes in the fair value of the derivative will be recorded in current period earnings. In all situations in which hedge accounting is discontinued and the derivative remains outstanding, the Bank will carry the derivative at its fair value on the balance sheet, recognizing changes in fair value in current period earnings.

The Bank may occasionally purchase a financial instrument in which a derivative instrument is "embedded." Upon purchasing the financial instrument, the Bank assesses whether the economic characteristics of the embedded derivative are clearly and closely related to the economic characteristics of the remaining component of the financial instrument and whether a separate, non-embedded instrument with the same terms as the embedded instrument would meet the definition of a derivate instrument. When it is determined that (1) the embedded derivative possesses economic characteristics that are not clearly and closely related to the economic characteristics of the host contract and (2) a separate, stand-alone instrument with the same terms would qualify as a derivative instrument, the embedded derivative is separated from the host contract, carried at fair value and designated as either a fair value or cash flow hedge. However, if the entire contract were to be measured at fair value, with changes in fair value reported in current earnings, or if the Bank could not reliably identify and measure the embedded derivative for purposes of separating that derivative from its host contract, the entire contract would be carried on the balance sheet at fair value and not be designated as a hedging instrument.

K. **Valuation Methodologies:** Management of the District applies various valuation methodologies 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, such as most investment securities. However, for those items for which an observable liquid market does not exist, management utilizes significant estimates and assumptions to value those items. Examples of these items include impaired loans, pension and other postretirement benefit obligations, and certain derivative and 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 District's results of operations.

L. **Recent Accounting Developments:** In June 2003, the American Institute of Certified Public Accountants' Accounting Standards Executive Committee (AcSEC) issued a proposed Statement of Position (SOP) – Allowance for Credit Losses, which was intended to clarify the methodology for estimating the allowance for credit losses and to enhance financial statement disclosures related to the allowance for credit losses. In January 2004, AcSEC dropped its proposed SOP and announced that it would focus instead on improving financial statement disclosures in this area.

System institutions plan to conduct studies to further refine their methodologies, including what are currently acceptable and permissible under generally accepted accounting principles, focusing specifically on the Securities and Exchange Commission and Federal Financial Institutions Examination Council guidelines. Such a study would likely be completed by the fourth quarter of 2004 with any appropriate changes to the allowance for loan losses implemented at that time.

In November 2002, the FASB issued FASB Interpretation No. 45, *"Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others."* The Interpretation elaborates on the disclosures to be made by a guarantor in its financial statements under certain guarantees that it has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The disclosure requirements of the Interpretation were adopted by the District as of December 31, 2002, and require disclosure of the nature of the guarantee, the maximum potential amount of future payments that the guarantor could be required to make under the guarantee, and the current amount of the liability, if any, for the guarantor's obligations under the guarantee. The recognition requirements of the Interpretation were effective beginning January 1, 2003. The initial implementation of the Interpretation did not have a significant effect on the District's combined financial position or combined results of operations and management does not anticipate any such impact in the future.

In April 2003, the FASB issued SFAS No. 149, *"Amendment of Statement 133 on Derivative Instruments and Hedging Activities."* The Statement amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under SFAS No. 133, *"Accounting for Derivative Instruments and Hedging Activities."* The Statement is effective for contracts entered into or modified after June 30, 2003, with certain exceptions, and for hedging relationships designated after June 30, 2003. In addition, the provisions of the Statement, with certain exceptions, were required to be applied prospectively. The initial implementation of the Statement did not have a material affect on the Bank's consolidated financial position or consolidated results of operations and management does not anticipate any such impact in the future.

In May 2003, the FASB issued SFAS No. 150, *"Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity."* SFAS No. 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. SFAS No. 150 applies specifically to a number of financial instruments that companies have historically presented within their financial statements either as equity or between the liabilities section and the equity section, rather than as liabilities. On November 7, 2003, the FASB issued FASB Staff Position (FSP) 150-3, *"Effective Date and Transition for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities."* FSP 150-3 defers the effective date of certain provisions of SFAS No. 150, specifically the provisions that apply to mandatorily redeemable noncontrolling interests. This deferral is expected to remain in effect indefinitely until the accounting for these interests is addressed in later guidance. The remaining provisions of SFAS No. 150 were effective for financial instruments entered into or modified after May 31, 2003, and otherwise were effective and adopted by the Bank on July 1, 2003. As a result of adoption, effective July 1, 2003, the Bank's mandatorily redeemable preferred stock of $225 million was reclassified to other liabilities and the related dividends paid on that stock are treated as interest expense beginning July 1, 2003 rather than as a direct reduction of unallocated surplus. See Note 8 for further discussion.

In December 2003, the FASB issued SFAS No. 132 (revised 2003), "*Employers' Disclosures about Pensions and Postretirement Benefits*." This Statement requires additional disclosures about the assets, obligations and cash flows of defined benefit pension and postretirement plans, as well as the expense recorded for such plans. As of December 31, 2003, the District has disclosed the required elements related to its benefit plans in Note 10 of the notes to combined financial statements.

In December 2003, the Accounting Standards Executive Committee (AcSEC) issued Statement of Position (SOP) 03-3, "*Accounting for Certain Loans or Debt Securities Acquired in a Transfer*." The SOP is effective for loans acquired in fiscal years beginning after December 15, 2004. The SOP addresses accounting for differences between contractual cash flows and cash flows expected to be collected from an investor's initial investment in loans or debt securities (loans) acquired in a transfer if those differences are attributable, at least in part, to credit quality. It includes loans acquired in business combinations. The SOP does not apply to loans originated by the District. The District intends to adopt the provisions of SOP 03-3 effective January 1, 2005, and does not expect the initial implementation to have a significant effect on the District's combined financial position or combined results of operations. Management is currently assessing the long-term effect of the SOP.

Note 3 — Investment Securities

A summary of the amortized cost and fair value of debt securities held as investments at December 31, 2003, 2002 and 2001, is as follows:

	December 31, 2003				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
Commercial Paper	$ 229,881	$ —	$ (2)	$ 229,879	1.10%
U.S. Govt. GNMA MBS/CMOs	910,675	3,154	(2,653)	911,176	1.99
U.S. Govt. Agency MBS	1,626,361	14,272	(6,218)	1,634,415	2.51
Non-Agency Whole Loans	20,281	1	(7)	20,275	1.49
Commercial MBS	1,717	—	—	1,717	1.39
Asset-Backed Securities	35,288	3	(37)	35,254	1.49
Total Investment Securities	$ 2,824,203	$ 17,430	$ (8,917)	$ 2,832,716	2.21%

	December 31, 2002				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
Commercial Paper	$ 259,807	$ 13	$ —	$ 259,820	1.51%
U.S. Govt. GNMA MBS/CMOs	823,773	4,825	(2,022)	826,576	2.37
U.S. Govt. Agency MBS	944,882	16,084	(698)	960,268	4.44
Non-Agency Whole Loans	37,954	178	(233)	37,899	3.53
Commercial MBS	3,241	—	(5)	3,236	1.64
Asset-Backed Securities	65,467	6	(154)	65,319	1.72
Total Investment Securities	$ 2,135,124	$ 21,106	$ (3,112)	$ 2,153,118	3.17%

	December 31, 2001				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
Commercial Paper	$ 280,555	$ 23	$ (2)	$ 280,576	2.15%
U.S. Govt. GNMA MBS/CMOs	196,515	4,333	(71)	200,777	5.71
U.S. Govt. Agency MBS	818,942	10,095	(4,246)	824,791	4.76
Non-Agency Whole Loans	141,447	1,999	(1,047)	142,399	5.10
Commercial MBS	6,517	—	(3)	6,514	2.27
Asset-Backed Securities*	208,209	79	(22)	208,266	2.55
Total Investment Securities	$ 1,652,185	$ 16,529	$ (5,391)	$ 1,663,323	4.17%

* *Includes corporate debt.*

AgFirst's investments consist primarily of mortgage-backed securities (MBSs), asset-backed securities (ABSs), and short-term money market securities. MBSs are collateralized by U.S. Government or U.S. agency guaranteed residential mortgages and have a AAA credit rating. ABSs are also rated AAA either by the deals senior/subordinate structure and/or a credit wrap by one of the bond insurers. Money market securities are short term in nature (from overnight maturities to maturities that range from 30 to 90 days) and are only made with financial institutions which carry sound credit ratings. All losses referenced above are related to changes in interest rates and are not credit related.

A summary of the expected maturity, amortized cost and estimated fair value of investment securities at December 31, 2003, follows:

	Amortized Cost	Fair Value	Weighted Average Yield
In one year or less	$ 229,881	$ 229,879	1.08%
After one year through five years	—	—	—
After five years through ten years	—	—	—
After ten years	914,234	928,917	2.65
Collateralized mortgage obligations	1,680,088	1,673,920	1.61
Total	$ 2,824,203	$ 2,832,716	2.21%

Substantially all collateralized mortgage obligations have contractual maturities in excess of ten years. However, expected maturities for collateralized mortgage obligations will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Proceeds from and realized gains and losses on investments in debt securities are as follows:

	Year Ended December 31,		
	2003	2002	2001
Proceeds on sales	$ 69,242	$ 92,510	$ 460,356
Realized gains	247	2,035	3,299
Realized losses	—	3,423	8,097

Note 4 — Loans and Allowance for Loan Losses

A summary of loans follows:

	December 31,		
	2003	2002	2001
Long-term farm mortgage	$ 6,333,228	$ 5,813,020	$ 4,177,711
Production and intermediate-term	5,427,642	5,365,864	5,931,092
Rural home	800,123	939,943	1,259,996
Farm-related business	201,181	178,773	150,404
Utility	401,535	403,169	384,034
Basic processing and marketing	268,113	235,822	224,454
Sales contracts/purchase money mortgage	41,118	15,103	16,611
Plus: Participations purchased	2,358,305	2,303,883	1,967,029
Less: Participations sold	(1,699,175)	(1,565,235)	(1,414,881)
Other	237,620	132,747	181,439
Total	$ 14,369,690	$ 13,823,089	$ 12,877,889

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

Total loans consisted of the following commodity types:

	Percent of Portfolio		
Commodity Group	**2003**	**2002**	**2001**
Poultry	12%	12%	13%
Forestry	10	10	10
Cattle	8	7	7
Grain	7	7	7
Dairy	7	7	6
Rural home	6	7	10
Nursery/Greenhouse	5	5	4
Swine	4	4	4
Tobacco	3	3	4
Citrus	3	4	4
Cotton	3	3	3
Utilities	3	3	3
Other	29	28	25
Total	100%	100%	100%

Impaired loans are loans for which it is probable that principal and interest will not be collected according to the contractual terms. Interest income recognized and cash payments received on nonaccrual impaired loans are applied as described in Note 2.

The following table presents information relating to impaired loans.

	December 31,		
	2003	**2002**	**2001**
Nonaccrual:			
Current as to principal and interest	$ 42,448	$ 50,431	$ 27,173
Past due	78,618	63,223	45,136
Accrual:			
Restructured	4,328	5,354	7,296
90 days or more past due	2,804	9,720	9,736
Total impaired loans	$ 128,198	$ 128,728	$ 89,341

There were no material commitments to lend additional funds to debtors whose loans were classified as impaired at December 31, 2003.

The following table presents interest income recognized on impaired loans.

	Year Ended December 31,		
	2003	**2002**	**2001**
Interest income recognized on nonaccrual loans	$ 11,520	$ 9,927	$ 10,649
Interest income on impaired accrual loans	1,434	1,874	1,796
Interest income recognized on impaired loans	$ 12,954	$ 11,801	$ 12,445

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

	2003	**2002**	**2001**
Impaired loans with related allowance	$ 42,695	$ 19,613	$ 13,364
Impaired loans with no related allowance	85,503	109,115	75,977
Total impaired loans	$ 128,198	$ 128,728	$ 89,341
Average impaired loans	$ 131,837	$ 124,274	$ 83,149
Allowance on impaired loans	$ 20,667	$ 10,671	$ 5,026

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

	Year Ended December 31,		
	2003	**2002**	**2001**
Balance at beginning of year	$ 311,180	$ 301,615	$ 284,867
Provision for (reversal of) loan losses	8,153	25,263	20,296
Loans charged off	(5,885)	(17,283)	(4,896)
Recoveries	3,287	1,585	1,348
Balance at end of year	$ 316,735	$ 311,180	$ 301,615

To mitigate the risk of loans being placed in nonaccrual status, System institutions may enter into a long-term standby commitment to purchase agreements with the Federal Agricultural Mortgage Corporation (Farmer Mac). The agreements, which are effectively credit guarantees that will remain in place until the loans are paid in full, give the Bank or Association the right to sell the loans identified in the agreements for "par" to Farmer Mac in the event a delinquency of four months occurs. The balance of loans under long-term standby commitments was $564 million, $411 million and $191 million at December 31, 2003, 2002 and 2001, respectively. Fees paid to Farmer Mac for such commitments totaled $2.2 million, $1.6 million and $311 thousand for the years ended December 31, 2003, 2002 and 2001, respectively. These amounts are classified as noninterest expense.

Note 5 — Premises and Equipment

Premises and equipment consisted of the following:

	December 31,		
	2003	**2002**	**2001**
Land	$ 12,715	$ 12,034	$ 11,919
Buildings and improvements	70,464	67,017	64,368
Furniture and equipment	72,462	70,232	68,802
Work in progress	10,442	4,605	538
	166,083	153,888	145,627
Less: accumulated depreciation	79,169	76,527	70,521
Total	$ 86,914	$ 77,361	$ 75,106

Note 6 — Other Assets and Other Liabilities

A summary of other assets and other liabilities follows:

	December 31,		
	2003	**2002**	**2001**
Other assets:			
Prepaid pension costs	$ 8,942	$ 9,800	$ 58,700
Derivative assets	3,484	1,920	11,248
Unamortized debt issue costs	9,109	7,168	5,494
Deferred preferred stock cost	3,974	2,331	2,608
Intangible asset related to pension	1,728	1,980	—
Prepaid expenses	760	600	501
Receivables and other	44,276	47,394	35,711
Total	$ 72,273	$ 71,193	$ 114,262
Other liabilities:			
Accounts payable	$ 23,361	$ 21,111	$ 24,715
Financial Assistance Corporation payable	78	8,795	9,644
Derivative liabilities	3,188	6,295	5,734
Farm Credit System Ins. Corp. payable	16,171	4,047	—
Bank draft payable	54,059	64,861	54,614
Other	52,546	40,033	55,049
Total	$ 149,403	$ 145,142	$ 149,756

Note 7 — Bonds and Notes

The System, unlike commercial banks and other depository institutions, obtains funds for its lending operations primarily from the sale of Systemwide Debt Securities issued by the Banks through the Funding Corporation. Certain conditions must be met before AgFirst can participate in the issuance of Systemwide debt securities. As one condition of participation, AgFirst is required by the Farm Credit Act and FCA regulations to maintain specified eligible assets, at least equal in value to the total amount of debt obligations outstanding for which it is primarily liable. This requirement does not provide holders of Systemwide debt securities with a security interest in any assets of the banks. In 1994, the System banks and the Funding Corporation entered into the Market Access Agreement (MAA), which established criteria and procedures for the banks to provide certain information and, under certain circumstances, for restricting or prohibiting an individual bank's participation in Systemwide debt issuances, thereby reducing other System banks' exposure to statutory joint and several liability. The MAA was amended and restated in July, 2003. At December 31, 2003, AgFirst was in compliance with the conditions of participation for the issuances of Systemwide debt securities.

Each issuance of Systemwide Debt Securities ranks equally, in accordance with the FCA regulations, with other unsecured Systemwide Debt Securities. Systemwide Debt Securities are not issued under an indenture and no trustee is provided with respect to these securities. Systemwide Debt Securities are not subject to acceleration prior to maturity upon the occurrence of any default or similar event.

The System may issue the following types of Systemwide Debt Securities:

- Federal Farm Credit Banks Consolidated Systemwide Bonds,
- Federal Farm Credit Banks Consolidated Systemwide Discount Notes,
- Federal Farm Credit Banks Consolidated Systemwide Master Notes,
- Federal Farm Credit Banks Global Debt Securities, and
- Federal Farm Credit Banks Consolidated Systemwide Medium-Term Notes.

For a discussion of the various risks, tax and other considerations, and terms and conditions related to each of these types of securities, see the discussions in the following offering circulars (available on the Funding Corporation's Web site located at *www.farmcredit-ffcb.com*), as applicable:

- The Federal Farm Credit Banks Consolidated Systemwide Bonds and Discount Notes Offering Circular dated June 18, 1999, as most recently amended by the supplement dated August 20, 2001,
- The Federal Farm Credit Banks Consolidated Systemwide Master Notes Offering Circular dated December 21, 1999, as most recently amended by the supplement dated August 20, 2001,
- The Federal Farm Credit Banks Global Debt Program Offering Circular dated October 10, 1996, which has not been amended by any supplements, and
- The Federal Farm Credit Banks Consolidated Systemwide Medium-Term Notes Offering Circular dated July 19, 1993, as most recently amended by the supplement dated June 11, 1999.

Each of these offering circulars may be further amended or supplemented from time to time. In addition, the Banks may in the future offer new types of Systemwide Debt Securities; the offering of any such securities will be pursuant to additional offering circulars.

The District's participation in Systemwide Debt Securities is as follows:

	Bonds		Medium-Term		Discount Notes		Total	
	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate	Amount
2004	1.24%	$ 4,452,194	—%	$ —	.99%	$ 1,758,352	1.17%	$ 6,210,546
2005	1.42	3,133,179	—	—	—	—	1.42	3,133,179
2006	2.17	1,878,846	6.33	10,845	—	—	2.19	1,889,691
2007	3.01	1,000,911	—	—	—	—	3.01	1,000,911
2008	2.90	1,082,582	—	—	—	—	2.90	1,082,582
2009	4.49	1,190,196	—	—	—	—	4.49	1,190,196
Total	2.01%	$ 12,737,908	6.33%	$ 10,845	.99%	$ 1,758,352	1.88%	$ 14,507,105

In the preceding table, weighted average interest rates include the effect of related derivative financial instruments.

Discount notes are issued with maturities ranging from 1 to 365 days. The average maturity of discount notes at December 31, 2003, was 34 days.

Systemwide Debt includes callable bonds and medium-term notes consisting of the following:

Amount	First Call Date	Year of Maturity
$ 6,073,000	2004	2004-2018
40,000	2005	2006
$ 6,133,000		

Callable debt may be called on the first call date and, any date thereafter.

As described in Note 1, the Insurance Fund is available to ensure the timely payment of principal and interest on Systemwide debt securities (insured debt) of System banks to the extent net assets are available in the Insurance Fund; all other liabilities on the financial statements are uninsured. At December 31, 2003 the assets of the Insurance Fund aggregated $2.033 billion; however, due to the other authorized uses of the Insurance Fund there is no assurance that any available amount in the Insurance Fund will be sufficient to fund the timely payment of principal of or interest on an insured debt obligation in the event of a default by any System bank having primary liability thereon. Amounts available in the Insurance Fund will be used to repay, upon maturity, the Financial Assistance Corporation debt issued to fund the purchase of $374 million of preferred stock issued by the Federal Land Bank of Jackson, to the extent that funds of the Financial Assistance Corporation Trust Fund (Trust Fund) are not sufficient for such purpose. As of December 31, 2003, available funds in the Trust Fund amounted to $73.8 million.

Note 8 — Mandatorily Redeemable Preferred Stock

As of December 31, 2003, AgFirst had 225,000 shares issued and outstanding of Mandatorily Redeemable Cumulative Preferred Stock at $1 thousand per share that is redeemable on December 15, 2016. Dividends on the preferred stock are payable at the rate of 8.393 percent per annum of the $1 thousand per share par value. Beginning March 15, 2012, the rate will change to a floating rate indexed to the 3-month LIBOR. On or after the dividend payment date in December 15, 2011, the preferred stock will be redeemable in whole or in part at the option of the Bank on any dividend payment date at its par value of $1 thousand per share. As discussed in Note 2, beginning in July 1, 2003, the Mandatorily Redeemable Preferred Stock was required to be reported prospectively as a liability and the related dividends reported prospectively as interest expense in accordance with SFAS No. 150. Although the Mandatorily Redeemable Preferred Stock is required to be reported as a liability under GAAP, it qualifies as capital for certain regulatory purposes.

Note 9 — Protected Borrower Equity and Shareholders' Equity

Descriptions of the District's capitalization requirements, protection mechanisms, regulatory capitalization requirements and restrictions, and equities are provided below.

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

B. **Preferred Stock:** On October 14, 2003, AgFirst issued 150,000 shares of Perpetual Non-Cumulative Preferred Stock. Dividends on the stock are payable at an annual rate equal to 7.30 percent. In the event dividends are not declared on the Preferred Stock for payment on any dividend Payment Date, then such dividends shall not cumulate and shall cease to accrue and be payable. On and after the Dividend Payment Date in December 2008, the Bank may, at its option, redeem the Preferred Stock in whole or in part at any time at the redemption price of $1 thousand per share plus accrued and unpaid dividends for then current Dividend Period to the date redemption.

   Payment of dividends or redemption price on the Preferred Stock may be restricted if the Bank fails to satisfy applicable minimum capital adequacy, surplus and collateral requirements.

C. **Capital Stock, Participation Certificates and Retained Earnings:** In accordance with the Farm Credit Act, borrowers are generally required to invest in their respective associations as a condition of borrowing. The District Associations' capital stock requirements are generally 2 percent of the amount of the loan. Some District Associations have dollar maximums, which range from $1 thousand to $5 thousand. Loans designated for sale or sold into the Secondary Market have no voting stock or participation certificate purchase requirement if sold within 180 days following the date of designation. Association capitalization plans presently establish stock requirements in accordance with the Farm Credit Act and their respective bylaws.

   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 added to the principal amount of the related loan obligation. AgFirst and the Association have a first lien on the stock or participation certificates owned by their respective borrowers. Retirement of such equities will generally be at the lower of par or book value and repayment of a loan cannot automatically result in retirement of the corresponding stock or participation certificates.

   District Associations:

   The District Associations in total are generally authorized to issue or have outstanding Classes A, C and D Preferred stock, Classes A, B, C and D Common stock, Classes A, B and C Participation Certificates, Assistance Preferred Stock 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 business. All classes of stock and participation certificates have a par or face value of five dollars ($5.00) per share.

The District Associations had the following shares outstanding at December 31, 2003:

Class	Protected Status	Shares Outstanding Number	Aggregate Par Value
A Common Nonvoting	Yes	142,600	$ 713
A Common Nonvoting	No	—	—
B Common Nonvoting	Yes	2,158,600	10,793
B Common Nonvoting	No	—	—
B Common Voting	No	—	—
C Common Voting	No	17,737,000	88,685
B Participation Certificates	Yes	189,600	948
C Participation Certificates	No	1,960,800	9,804
Participation Certificates	No	—	—
A Preferred	No	3,370,800	16,854
C Preferred	No	139,400	697
Total Association Capital Stock and Participation Certificates		25,698,800	$ 126,155

Protected common stock and participation certificates are retired at par or face value in the normal course of business. At-risk common stock and participation certificates are retired at the sole discretion of the respective boards of directors (Boards) at book value not to exceed par or face amounts, provided the minimum capital adequacy standards established by the Boards are met.

Participation Certificates are nonvoting and may be issued as a condition for obtaining a loan to rural home borrowers, to persons or organizations furnishing farm-related services, to persons or organizations who are eligible to borrow or participate in loans, but who are not eligible to hold voting stock, and to persons or organizations eligible to borrow for the purpose of qualifying them for technical assistance, financially related services, and/or leasing services offered by the Association.

Preferred Stock may be issued to such persons or investors as may be permitted under a plan adopted by each Board. Retirement will be at the sole discretion of each Board provided that the minimum capital adequacy standards established by the Board are met. If retired, Preferred Stock will be retired at its book value, not to exceed its par value. Preferred Stock is nonvoting and generally has preference over common stock and participation certificates as to dividends, and priority in the event of liquidation of an Association.

Retained Earnings

The District Associations maintain unallocated retained earnings accounts and allocated retained earnings accounts. The minimum aggregate amounts of these two accounts are determined by each 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 an 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.

The District Associations maintain allocated retained earnings accounts consisting of earnings held and allocated to borrowers on a patronage basis. In the event of a net loss by an Association 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 District Associations have 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, an Association, upon approval of its 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 FCA and the Board are met. All nonqualified distributions are tax deductible only when redeemed.

At December 31, 2003, combined allocated retained earnings consisted of $541,622 of qualified surplus, $133,499 of nonqualified allocated surplus and $117,151 of nonqualified retained surplus.

Dividends

An Association may declare dividends on its capital stock and participation certificates. Such dividends generally may be paid solely on Preferred Stock, or on all classes of stock and participation certificates.

Patronage Distributions

Prior to the beginning of any fiscal year, each Board, by adoption of a resolution, may obligate its 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, if made by that Association, are based on the proportion of the borrower's interest to the amount of interest earned by that Association on its total loans unless another proportionate patronage basis is approved by the Board.

If an Association will meet 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 retained earnings account, or combinations 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.

Amounts not distributed are retained as unallocated retained earnings.

Transfer

Equities may generally be transferred to persons or entities eligible to purchase or hold such equities.

Impairment

Any net losses recorded by an Association shall first be applied against unallocated retained earnings. To the extent that such losses would exceed unallocated retained earnings, resulting in impairment of the Association's allocated retained earnings or capital stock, such losses would be applied pro rata to each share and/or unit outstanding, provided applications shall be made to allocated retained earnings by annual series with the most recent allocations applied first.

Liquidation

In the event of the liquidation or dissolution of an Association, any assets of the Association remaining after payment or retirement of all liabilities may be distributed either to the holders of the outstanding stock and participation certificates or on a patronage basis, dependent upon the bylaws of the Association.

AgFirst:

Capital stock and allocated retained earnings — District Associations are required to invest in the capital stock of AgFirst. These intercompany balances and transactions are eliminated in combination. Additionally, AgFirst has issued and has outstanding $11,531 in Class D Common stock, which is a nonvoting class of stock with a $5.00 par value.

Other Equity — At the inception of each other financing institutions (OFI) loan, AgFirst requires OFIs to make cash purchases of participation certificates in AgFirst. In addition, OFIs receive participation certificates and allocated retained earnings from AgFirst's distribution of net income on a percentage basis. AgFirst has a first lien on these equities for the repayment of any indebtedness to AgFirst. At December 31, 2003, AgFirst had $528 of participation certificates outstanding to OFIs at a face value of $5.00 per share.

Regulatory Capitalization Requirements and Restrictions

FCA's capital adequacy regulations require AgFirst and District Associations 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 the FCA that, if undertaken, could have a direct material effect on AgFirst's or District Associations' financial statements. AgFirst and District Associations are prohibited from reducing permanent capital by retiring stock or making certain other distributions to shareholders unless the prescribed capital standard is met. FCA regulations also require that additional minimum capital standards 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 core surplus as a percentage of risk-adjusted assets of three and one-half percent. The following table shows the ranges of capital standards for the entities within the District at December 31, 2003.

	Permanent Capital Ratio Ranges	Core Surplus Ratio Ranges	Total Surplus Ratio Ranges
AgFirst	25.99%	14.45%	25.79%
District Associations	12% – 26%	8% – 25%	10% – 25%

AgFirst's capital adequacy is also evaluated using a ratio of net collateral to total liabilities. Subsequent to the issuance of the preferred stock, FCA now requires AgFirst to maintain a minimum net collateral ratio of 104 percent compared to the regulatory minimum of 103 percent. At December 31, 2003, AgFirst's net collateral ratio was 106.94 percent.

Included in the above table as of December 31, 2003, are twenty-two Associations that have reorganized through the creation of FLCA and PCA subsidiaries. These subsidiaries and the ACA operate under a common board of directors and joint management. As a result, these District Associations are jointly obligated on each other's liabilities and are evaluated on a consolidated basis for capital adequacy and other regulatory purposes.

All District entities were in compliance with the required minimum capital standards at December 31, 2003.

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. AgFirst and District Associations have not been called upon to initiate any transfers and are not aware of any proposed action under this regulation.

Note 10 — Income Taxes

The provision (benefit) for income taxes follows for the year ended December 31:

	Year Ended December 31, 2003	2002	2001
Current:			
Federal	$ 1,960	$ 225	$ 5,466
State	248	(427)	1,397
ACA tax refunds	(901)	(5,834)	(34,003)
	1,307	(6,036)	(27,140)
Deferred:			
Federal	(230)	3,664	(1,731)
State	(218)	(379)	(62)
Write-off deferred tax assets	—	6,935	9,523
	(448)	10,220	7,730
Total provision (benefit) for income taxes	$ 859	$ 4,184	$ (19,410)

In connection with the restructuring of Associations into holding companies, as previously discussed, deferred tax assets of $0, $6,935 and $9,523 relating to the corporate restructuring and long-term lending activities were written off during 2003, 2002 and 2001, respectively, to reflect the change in tax status. Additionally, from 2000 through 2002, Associations signed settlement agreements with the IRS resolving the taxability of the prior years' earnings from its long-term mortgage lending activities. This settlement agreement was modeled after one used by another System ACA to reach a settlement agreement with the

IRS in August 2000. As a result of this settlement, the Associations recorded tax refunds of $901, $5,835 and $34,003 in 2003, 2002 and 2001, respectively, which is included as a component of the 2003, 2002 and 2001 current income tax provision. In addition, the Associations recorded $71, $2,865 and $12,094 in interest related to these refunds in 2003, 2002 and 2001, respectively, which is included in noninterest income in the accompanying Combined Statements of Income.

The provision 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:

	Year Ended December 31, 2003	2002	2001
Federal tax at statutory rate	$ 109,038	$ 107,580	$ 96,503
State tax, net	341	74	1,150
Tax-exempt FLCA earnings	(48,942)	(40,676)	(27,971)
Association patronage distributions	(33,353)	(35,223)	(45,163)
Nontaxable Bank income	(31,015)	(29,004)	(21,198)
Possessions credit (Puerto Rico)	(511)	(690)	(1,046)
ACA tax refunds	(901)	(5,834)	(34,003)
Write-off of deferred tax assets	—	6,935	9,523
Other	6,202	1,022	2,795
Provision for income taxes	$ 859	$ 4,184	$ (19,410)

Deferred tax assets and liabilities are comprised of the following at:

	December 31, 2003	2002	2001
Allowance for loan losses	$ 21,971	$ 21,712	$ 24,941
Annual leave	158	162	638
Nonaccrual loan interest	1,164	1,579	2,162
Postretirement benefits other than pensions	1,087	1,259	3,738
Financial assistance payable	—	198	198
Nonqualified patronage distributions	15.875	13,897	11,827
Other	5,344	1,738	1,496
Gross deferred tax asset	45,599	40,545	45,000
Deferred tax asset valuation allowance	(18,142)	(15,577)	(6,515)
Future Bank stock redemptions	(4,684)	(3,442)	(3,609)
Bank patronage	(2,909)	(4,284)	(4,515)
State income tax	(1,087)	(802)	(751)
Loan fees	(1,694)	(1,602)	(1,978)
Pensions	(995)	(939)	(3,061)
Depreciation	(101)	(104)	(169)
Other	(2,684)	(34)	(421)
Gross deferred tax liability	(14,154)	(11,207)	(14,504)
Net deferred tax asset	$ 13,303	$ 13,761	$ 23,981

At December 31, 2003, deferred income taxes have not been provided by District Associations on approximately $127 million of patronage refunds received from the Bank prior to January 1, 1993. Such refunds, distributed in the form of stock, are subject to tax only upon conversion to cash. The tax liability related to future conversions is not expected to be material.

Note 11 — Employee Benefit Plans

The employees of the District participate in one of three defined benefit retirement plans within the District. The first plan (the District Plan) covers employees of nineteen Associations and AgFirst. The second plan covers employees of four ACAs, and the third plan covers employees of a single ACA. Each plan is noncontributory and covers substantially all employees of the participating entities. The "Projected Unit Credit" actuarial method is used for financial reporting purposes, and the "Entry Age Normal Cost" method is used for funding purposes. As a result of the funded status of the District's defined benefit retirement plans at the measurement date (September 30) of the underlying Plan, the District may record a minimum liability, an intangible asset relating to unrecognized prior service cost and an adjustment to other comprehensive income (loss). The adjustment to other comprehensive income (loss) would be net of deferred taxes, if significant.

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

	PENSION BENEFITS As of December 31,		
(dollars in thousands)	2003	2002	2001
Change in benefit obligation			
Benefit obligation at beginning of year	$ 324,397	$ 281,348	$ 241,090
Service cost	11,159	9,324	8,306
Interest cost	21,268	20,619	17,764
Actuarial loss (gain)	30,744	33,809	28,366
Benefits paid	(14,973)	(18,510)	(16,386)
Other	(437)	(2,193)	2,208
Benefit obligation at end of year	$ 372,158	$ 324,397	$ 281,348
Change in plan assets			
Fair value of plan assets at beginning of year	$ 214,702	$ 236,444	$ 300,831
Actual return on plan assets	41,407	(15,471)	(58,294)
Employer contributions	17,537	12,239	10,293
Benefits and premiums paid	(14,973)	(18,510)	(16,386)
Fair value of plan assets at end of year	$ 258,673	$ 214,702	$ 236,444
Funded Status	$ (113,485)	$ (109,695)	$ (44,904)
Unrecognized net actuarial loss (gain)	167,951	167,145	100,630
Unamortized prior service cost	3,722	1,980	5,014
Unrecognized net (asset) or obligation	(1,364)	(1,702)	(2,040)
Net amount recognized	$ 56,824	$ 57,728	$ 58,700
Amounts recognized in the statement of financial position consisted of:			
Prepaid benefit costs	$ 8,942	$ 9,800	$ 58,700
Accrued benefit liability	(52,519)	(61,822)	—
Intangible asset	1,728	1,980	—
Accumulated other comprehensive income	98,673	107,770	—
Net amount recognized	$ 56,824	$ 57,728	$ 58,700
Information for pension plans with an accumulated benefit obligation in excess of plan assets at December 31:			
Projected benefit obligation	$ 324,647	$ 283,848	
Accumulated benefit obligation	271,507	241,914	
Fair value of plan assets	218,989	180,092	
Components of net periodic benefit cost			
Service cost	$ 11,159	$ 9,263	$ 8,306
Interest cost	21,268	20,504	17,764
Expected return on plan assets	(18,857)	(21,548)	(24,129)
Amortization of net (gain) loss	(338)	(341)	(686)
Amortization of prior service cost	648	648	648
Recognized net actuarial (gain) loss	9,558	5,086	(12)
Net periodic benefit cost	$ 23,438	$ 13,612	$ 1,891
Additional Information			
Increase (decrease) in minimum liability included in other comprehensive income	$ (9,303)	$ 61,822	
ASSUMPTIONS:			
Weighted average assumptions used to determine benefit obligations at December 31			
Discount rate	6.25%	6.75%	7.50%
Rate of compensation increase	4.46%	4.00%	4.00%
Weighted average assumptions used to determine net periodic benefit cost for years ended December 31			
Discount rate	6.25%	6.75%	7.50%
Expected return on plan assets	8.88%	8.87%	9.00%
Rate of compensation increase	4.46%	4.00%	4.00%

The District expects to contribute $19,000 to its pension plan in 2004.

Plan assets are invested using active investment strategies utilizing multiple investment management firms. Managers within each asset class cover a range of investment styles and approaches are combined in a way that controls for capitalization, and style biases (equities), and interest rate anticipation strategies (fixed income) vs. benchmark indices while focusing primarily on issue selection as a means to add value. Risk is controlled through diversification among multiple asset classes, managers, styles, and securities. Risk is further controlled both at the manager and asset class level by assigning excess return and tracking error targets. Monitoring activities take place to evaluate performance against these targets. The target asset allocation is 45 percent U.S. equity, 25 percent Non-U.S. equity, and 30 percent fixed income.

Allowable investment types include:

U.S. Equity: Common stocks of large, medium, and small companies, which are predominantly U.S. based.

Non-U.S. Equity: Equity securities issued by companies domiciled outside the U.S. and in depository receipts, which represent ownership of securities of non-U.S. companies.

Fixed Income: Fixed income securities issued or guaranteed by the U.S. government, and to a lesser extent by non-U.S. governments, or by their respective agencies and instrumentalities, mortgage backed securities, including collateralized mortgage obligations, corporate debt obligations and dollar-denominated obligations issued in the U.S. by non-U.S. banks and corporations (Yankee bonds).

PLAN ASSETS	2003	2002	2001
Asset Category			
Equity securities	70.2%	67.3%	64.1%
Debt securities	29.1	31.7	34.7
Other	.7	1.0	1.2
	100.0%	100.0%	100.0%

Target allocation for asset categories for 2004 are as follows:

Asset Category	
Equity securities	70%
Debt securities	30%
	100%

The overall expected long-term rate of return on assets assumption is based on the target asset allocation for Plan assets, capital markets forecasts for asset classes employed, and active management excess return expectations. The total return for bonds is based on an equilibrium yield assumed to be 6 percent for government bonds plus an additional 0.5 percent due to the exposure of corporate debt in an aggregate benchmark, for a total return of 6.5 percent. A 3 percent equity premium is added to arrive at the forecast for equity returns, both foreign and domestic. Equilibrium forecasts are used to reflect long-term expectations for the asset classes employed. To the extent asset classes are actively managed, an excess return premium is added.

The District also participates in a Districtwide defined contribution Thrift Plan. For employees hired on or prior to December 31, 2002, the Bank and Associations will contribute $.50 for each $1.00 of the maximum employee contribution of 6 percent of total compensation. For employees hired on or after January 1, 2003, the Bank and Associations will contribute $1.00 for each $1.00 of the 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 were $3,601, $3,318 and $3,065 for 2003, 2002 and 2001, respectively.

In addition to providing pension benefits, the Bank and District Association provides certain health care and life insurance benefits for the retired employees (other postretirement benefits). Substantially all employees may become eligible for the benefits if they reach normal retirement age while working for the Bank or District Association.

The following is a table of other postretirement benefits expenses:

	OTHER POSTRETIREMENT BENEFITS		
	As of December 31,		
(dollars in thousands)	2003	2002	2001
Change in benefit obligation			
Benefit obligation at beginning of year	$ 137,442	$ 97,841	$ 76,922
Service cost	3,633	2,695	2,170
Interest cost	9,089	7,180	6,011
Curtailments	—	—	792
Actuarial loss (gain)	5,637	35,142	16,966
Benefits paid	(5,419)	(5,416)	(5,020)
Benefit obligation at end of year	$ 150,382	$ 137,442	$ 97,841
Change in plan assets			
Fair value of plan assets at beginning of year	$ 194	$ 207	$ 665
Actual return on plan assets	—	17	53
Employer contributions	5,225	5,386	4,509
Benefits and premiums paid	(5,419)	(5,416)	(5,020)
Fair value of plan assets at end of year	$ —	$ 194	$ 207
Funded Status	$ (150,382)	$ (137,248)	$ (97,634)
Unrecognized net actuarial loss (gain)	56,172	52,042	17,548
Unrecognized prior service cost	(1,629)	(387)	(419)
Unrecognized net (asset) or obligation	16,590	18,400	20,190
Net amount recognized	$ (79,249)	$ (67,193)	$ (60,315)
Amounts recognized in the statement of financial position consisted of:			
Prepaid benefit costs	$ —	$ —	$ —
Accrued benefit liability	(79,249)	(67,193)	(60,315)
Intangible asset	—	—	—
Accumulated other comprehensive	—	—	—
Net amount recognized	$ (79,249)	$ (67,193)	$ (60,315)
Components of net periodic benefit			
Service cost	$ 3,633	$ 2,695	$ 2,170
Interest cost	9,089	7,180	6,011
Expected return on plan assets	(5)	(12)	(38)
Amortization of net (gain) loss	1,790	1,791	1,793
Amortization of prior service cost	(93)	(60)	86
Recognized net actuarial (gain) loss	2,965	699	634
Net periodic benefit (income) cost	$ 17,379	$ 12,293	$ 10,656
ASSUMPTIONS:			
Weighted average assumptions used to determine benefit obligations at December 31			
Discount rate	6.25%	6.75%	7.50%
Weighted average assumptions used to determine net periodic benefit cost for years ended December 31			
Discount rate	6.75%	7.50%	8.00%
Expected return on plan assets	N/A	8.00%	9.00%
Assumed health care cost trend rates at December 31			
Health care cost trend rate assumed for next year	10%-12%	10%-12%	11%-13%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	5.00%	5.00%	4.75%
Year that the rate reaches the ultimate trend rate	2013	2011	2012

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following effects:

	1 Percentage Point Increase	1 Percentage Point Decrease
Effect on total of service and interest cost	$ 2,536	$ (2,170)
Effect on postretirement benefit obligation	25,371	(19,074)

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (Medicare Act) was signed into law. This act introduces a prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. Subsidies under the Medicare Act will reduce the current period measurements of benefits expected to be provided in future periods. The combined financial statements and disclosures do not reflect the effects of the Act. Specific authoritative guidance on the accounting for the federal subsidy is pending and that guidance, when issued, could require changes to previously reported information.

Note 12 — Intra-System Financial Assistance

The Farm Credit System Financial Assistance Corporation (Financial Assistance Corporation) was established in 1988 primarily to provide capital to institutions of the System experiencing financial difficulty. Such assistance was funded through the Financial Assistance Corporation's issuance of $1.261 billion of 15-year U.S. Treasury-guaranteed debt. The interest rates on these issuances range from 8.80 percent to 9.45 percent.

The proceeds from the debt offerings were used to fund existing intra-System financial assistance payables ($417 million), to purchase preferred stock from certain troubled System banks ($808 million), and for other purposes ($36 million). Pursuant to the Farm Credit Act, the U.S. Treasury paid the interest on $844 million of the Financial Assistance Corporation bonds for the first five years of the respective terms of such bonds. The payment of interest on this debt was allocated between the U.S. Treasury and System banks during the second five years. As the result of growth of the System's surplus, the allocation provisions of the Farm Credit Act require that banks pay 100 percent of the interest beginning in 1999. The Farm Credit Act and supplemental agreements dictate how the banks will repay the principal and fund the interest of each type of issuance. With the exception of the assistance provided through the purchase of preferred stock, repayment of the Financial Assistance Corporation debt obligations will be allocated to all System banks, and annual expense accruals and funding assessments are generally allocated based on each bank's proportion of System loan volume over various time periods.

Financial assistance was provided by the Financial Assistance Corporation to five System banks in other districts through its purchase of preferred stock of those institutions. Through 1994, four System banks redeemed their preferred stock in the amount of $419 million through the transfer of assets to the Financial Assistance Corporation, which were placed in trusts. The Federal Land Bank of Jackson, whose charter was canceled in January of 1995, received $374 million of financial assistance for which the related preferred stock has not been redeemed.

All interest advanced by the U.S. Treasury must be repaid by System banks in 2005. System banks record their share of the liability based upon each bank's proportionate share of average accruing retail loan volume. To fund the repayment obligation, annual annuity-type payments are made by each bank to the Financial Assistance Corporation in an amount designed to accumulate, in total, including earnings thereon, the total amount of each bank's ultimate obligation.

The Financial Assistance Corporation assumed certain payables previously accrued by AgFirst under the System's Capital Preservation Agreements and funded payment of such accruals by the issuance of 15-year U.S. Treasury-guaranteed debt. Under the Farm Credit Act, the System banks are required to fund the bonds upon maturity. Although GAAP requires recognition in the financial statements of AgFirst's liability to the Financial Assistance Corporation, the Farm Credit Act states that, for all financial reporting purposes, this obligation shall not be considered a liability of any System bank until the maturity of such debt. This debt matured on July 21, 2003. There is a statutorily mandated repayment plan, which effectively spreads the financial assistance payments and expenses over a number of years and accordingly gradually reduced the effect of the unrecorded liability. Management considers the current and future effect of not recording the liability to be immaterial to AgFirst's financial condition and results of operations.

The District's financial assistance expense totaled $13 million, $15 million and $14 million in 2003, 2002 and 2001, respectively.

Note 13 — Related Party Transactions

In the ordinary course of business, the District enters into loan transactions with officers and directors of AgFirst or Associations, 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, 2003, amounted to $226,193. During 2003, $232,327 of new loans were made and repayments totaled $199,280. In the opinion of management, no material amounts outstanding at December 31, 2003, involved more than a normal risk of collectibility.

Note 14 — Regulatory Enforcement Matters

At December 31, 2003, there were no regulatory enforcement matters or agreements in place with the FCA.

Note 15 — Commitments and Contingencies

The District has various contingent liabilities and commitments outstanding as discussed elsewhere in these notes to combined financial statements. While primarily liable for its portion of bonds and notes, AgFirst is jointly and severally liable for the bonds and notes of the other System banks. The total bonds and notes of the System at December 31, 2003 were $94.2 billion.

In the normal course of business, the Bank and Associations may participate in credit related financial instruments with off-balance-sheet risk to satisfy the financing needs of their borrowers. These financial instruments include standby letters of credit, various guarantees and commitments to extend credit.

Standby letters of credit are unconditional commitments issued by the Bank and District Associations to guarantee the performance of a customer to a third party. As of December 31, 2003, the Bank had $63.4 million in letters of credit with non-District entities with $5.9 million expiring in less than one year, $51.1 million due to expire in one to three years and the remaining $6.4 million have terms that will expire from 2008 to 2011. As of December 31, 2003, the District Associations had $42.6 million in letters of credit with terms predominantly of one to three years. The notional amounts of these guarantees represent the maximum amount of exposure the Bank and the District Associations have related to these instruments as of December 31, 2003.

At December 31, 2003, $2.8 billion of commitments to extend credit were outstanding. Since many of these commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. However, these financial instruments have off-balance-sheet credit risk because their amounts could be drawn upon at the option of the borrower. The credit risk associated with issuing commitments and letters of credit is substantially the same as that involved in extending loans to borrowers and the same credit policies are applied by management. Upon fully funding a commitment, the credit risk amounts are equal to the contract amounts, assuming that borrowers fail completely to meet their obligations and the loan collateral 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.

In addition, the Bank owns an 18 percent minority interest in the Farm Credit Leasing Services Corporation (FCLSC), a subsidiary of CoBank, ACB, which is also a bank of the Farm Credit System and is regulated by FCA. Pursuant to a stockholder agreement, AgFirst guarantees its 18 percent pro rata share of FCLSC's note payable to CoBank. At December 31, 2003, the Bank's portion of the FCLSC note payable to CoBank totaled $124.2 million. As of January 1, 2004, AgFirst sold its ownership interest to CoBank and eliminated its contingent liability.

As of December 31, 2003, AgFirst also indemnifies leases in the amount of $4.1 million on behalf of FCLSC with lease terms expiring in 2009.

Actions are pending against AgFirst and certain District Associations in which claims for money damages are asserted. On the basis of information presently available, management and legal counsel are of the opinion that the ultimate liability, if any, from these other actions, would not be material in relation to the combined financial position of AgFirst and District Associations.

Note 16 — Disclosures about Fair Value of Financial Instruments

The following table presents the carrying amounts and fair values of the District's financial instruments at December 31, 2003, 2002 and 2001. 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 District's financial instruments are as follows:

	December 31, 2003		December 31, 2002		December 31, 2001	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:						
Loans	$ 14,369,690	$ 14,672,307	$ 13,823,089	$ 14,184,579	$ 12,877,889	$ 13,007,140
Allowance for loan losses	(316,735)	—	(311,180)	—	(301,615)	—
Loans, net	$ 14,052,955	$ 14,672,307	$ 13,511,909	$ 14,184,579	$ 12,576,264	$ 13,007,140
Other assets	$ 3,484	$ 3,484	$ 1,920	$ 1,920	$ 11,248	$ 11,248
Cash & investment securities	$ 3,327,055	$ 3,327,055	$ 2,597,575	$ 2,597,575	$ 2,002,864	$ 2,002,864
Financial liabilities:						
Systemwide debt securities	$ 14,507,105	$ 14,475,670	$ 13,538,536	$ 13,584,445	$ 12,115,709	$ 12,134,913
Financial assistance related liabilities*	$ 78	$ 2,660	$ 8,795	$ 12,095	$ 9,644	$ 13,536
Other liabilities	$ 3,188	$ 3,188	$ 6,295	$ 6,295	$ 5,734	$ 5,734

* *The above amount excludes the assumption of Third Quarter 1986 Capital Preservation Agreement obligations with a fair value of $6.8 million at December 31, 2002. The obligation was paid in July 2003.*

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

A. **Loans:** Because no active market exists for the District's loans, fair value is estimated by discounting the expected future cash flows using the District's current interest rates at which similar loans would be made to borrowers with similar credit risk. Since the discount rates are based on the District'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 are estimated to be the carrying amount of the loan less specific reserves. The carrying value of accrued interest approximates its fair value.

B. **Cash, Federal Funds and Securities Purchased Under Resale Agreements:** The carrying value is a reasonable estimate of fair value.

C. **Investment Securities:** Fair value is based upon currently quoted market prices.

D. **Systemwide Debt Securities:** Bonds and notes are not regularly traded; thus, quoted market prices are not available. Fair value of these instruments is estimated by discounting expected future cash flows based on the quoted market price of similar maturity Treasury notes, assuming a constant estimated yield spread relationship between Systemwide bonds and notes and comparable Treasury notes.

E. **Financial Assistance Related Liabilities:** As discussed in Note 12, the District is liable for certain obligations of the Financial Assistance Corporation, one of which is unrecorded. Fair value of these obligations is determined by discounting the cumulative expected future cash outflows of all of the obligations using an interest rate commensurate with bonds having a similar maturity.

F. **Derivative Instruments:** The fair value of derivatives is the estimated amount to be received or paid to replace the instruments at the reporting date, considering current and projected interest rates. Where actively quoted market prices do not exist, estimated fair values are determined through dealer quotes.

G. **Commitments to Extend Credit and Standby Letters of Credit:** The fair value of commitments is estimated using the fees currently charged to enter similar agreements, taking into account the remaining terms of the agreement and the creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of letters of credit is based on an estimate of the cost to terminate the agreement or fees currently charged for similar agreements. The estimated market value of off-balance-sheet commitments is considered to be nominal since the committed rate approximates current rates offered for commitments with similar rate and maturity characteristics and since the related credit risk is also considered not to be significant.

Note 17 — Derivative Instruments and Hedging Activities

The District maintains an overall interest rate risk management strategy that incorporates the use of derivative instruments to minimize significant unplanned fluctuations in earnings that are caused by interest rate volatility. The District's goal is to manage interest rate sensitivity by modifying the repricing or maturity characteristics of certain balance sheet assets and liabilities so that the net interest margin is not adversely affected by movements in interest rates. As a result of interest rate fluctuations, hedged fixed-rate assets and liabilities will appreciate or depreciate in market value. The effect of this unrealized appreciation or depreciation is expected to be substantially offset by the District's gains or losses on the derivative instruments that are linked to these hedged assets and liabilities. Another result of interest rate fluctuations is that the interest income and interest expense of hedged variable-rate assets and liabilities, respectively, will increase or decrease. The effect of this variability in earnings is expected to be substantially offset by the District's gains and losses on the derivative instruments that are linked to these hedged assets and liabilities. The District considers its strategic use of derivatives to be a prudent method of managing interest rate sensitivity, as it prevents earnings from being exposed to undue risk posed by changes in interest rates.

The District enters into derivatives, particularly interest rate swaps, to lower funding costs, diversify sources of funding, or alter interest rate exposures arising from mismatches between assets and liabilities. Interest rate swaps allow the District to raise long-term borrowings at fixed rates and swap them into floating rates that are lower than those available to the District if floating rate borrowings were made directly. Under interest rate swap arrangements, the District agrees with other parties to exchange, at specified intervals, payment streams calculated on a specified notional principal amount, with at least one stream based on a specified floating rate index.

The District may purchase interest rate options such as caps, in order to reduce the impact of rising interest rates on its floating-rate debt, and floors, in order to reduce the impact of falling interest rates on their floating-rate assets. There are no floors outstanding currently.

By using derivative instruments, the District exposes itself to credit and market risk. If a counterparty fails to fulfill its performance obligations under a derivative contract, the District's credit risk will equal the fair value gain in the derivative. Generally, when the fair value of a derivative contract is positive, this indicates that the counterparty owes the District, thus creating a repayment risk for the District. When the fair value of the derivative contract is negative, the District owes the counterparty and, therefore, assumes no repayment risk.

To minimize the risk of credit losses, the District deals with counterparties that have an investment grade or better credit rating from a major rating agency, and also monitor the credit standing of and levels of exposure to individual counterparties. Transactions with six counterparties represent approximately .33 percent of the total notional amount of interest rate swaps. The District does not anticipate nonperformance by any of these counterparties. The District typically enters into master agreements that contain netting provisions. These provisions allow the District to require the net settlement of covered contracts with the same counterparty in the event of default by the counterparty on one or more contracts. A number of swaps are supported by collateral arrangements with counterparties. At December 31, 2003, the District had not posted collateral with respect to these arrangements.

The District's derivative activities are monitored by its Asset-Liability Management Committee (ALCO) as part of the Committee's oversight of the District's asset/liability and treasury functions. The District's ALCO is responsible for approving hedging strategies that are developed through its analysis of data derived from financial simulation models and other internal and industry sources. The resulting hedging strategies are then incorporated into the District's overall interest rate risk-management strategies.

Note 18 — Additional Derivative Financial Instruments and Other Financial Instruments Disclosure

The table below provides information about derivative financial instruments and other financial instruments that are sensitive to changes in interest rates, including debt obligations and interest rate swaps. The debt information below represents the principal cash flows and related weighted average interest rates by expected maturity dates. The derivative information below represents the notional amounts and weighted average interest rates by expected maturity dates.

December 31, 2003 *(dollars in millions)*	**Maturities of 2003 Derivative Products** 2004	2005	2006	2007	2008	After 2009	Total	Fair Value
Systemwide Debt Securities:								
Fixed rate	$ 3,505	$ 1,544	$ 1,399	$ 901	$ 807	$ 1,190	$ 9,346	$ 9,222
Weighted average interest rate	1.28%	1.78%	2.58%	3.22%	3.51%	4.49%	2.81%	
Variable rate	2,510	1,589	490	100	276	—	4,965	5,024
Weighted average interest rate	1.04%	1.06	1.08	1.09	1.10	—	.90%	
Derivative Instruments:								
Receive fixed swaps								
Notional value	$ 75	$ 25	$ 275	$ 25	$ 140	$ —	$ 540	$ 2
Weighted average receive rate	2.48%	1.74%	2.55%	3.50%	3.37%	—	2.76%	
Weighted average pay rate	1.00%	1.03%	1.17%	1.03%	1.03%	—	1.10%	
Amortizing floating for floating swaps								
Notional value	81	233	312	—	—	—	626	(2)
Weighted average receive rate	2.16%	1.69%	1.22%	—	—	—	1.52%	
Weighted average pay rate	4.38%	2.56%	1.34%	—	—	—	2.19%	
Interest rate caps								
Notional value	—	1,569	264	—	—	—	1,833	2
Other derivative products								
Notional value — TBAs	54	—	—	—	—	—	54	
Total notional value	$ 210	$ 1,827	$ 851	$ 25	$ 140	$ —	$ 3,053	$ 2
Total weighted average rates on swaps:								
Receive rate	2.31%	1.69%	1.84%	3.50%	3.37%	—%	2.09%	
Pay rate	2.76%	2.41%	1.26%	1.03%	1.03%	—%	1.67%	

(dollars in millions)	**Less than 1 year**	**1 to 5 Years**	**Over 5 Years**	**Maturity Distribution Netting**	**Exposure**	**Collateral Held**	**Exposure Net of Collateral**
Credit Rating							
AAA	$ —	$ 1	$ —	$ (1)	$ —	$ —	$ —
AA	—	1	—	—	1	—	1
A	—	1	—	—	1	—	1
Total	$ —	$ 3	$ —	$ (1)	$ 2	$ —	$ 2

Note 19 — Quarterly Financial Information (Unaudited)

Quarterly results of operations for the years ended December 31, 2003, 2002 and 2001 follow:

	2003				
	First	Second	Third	Fourth	Total
Net interest income	$ 143,582	$ 148,859	$ 142,074	$ 141,398	$ 575,913
Provision for loan losses	5,456	3,628	(281)	(650)	8,153
Noninterest income (expense), net	(55,340)	(62,721)	(63,489)	(65,720)	(247,270)
(Provision) benefit for income taxes	(313)	371	(17)	(900)	(859)
Net income	$ 82,473	$ 82,881	$ 78,849	$ 75,428	$ 319,631

	2002				
	First	Second	Third	Fourth	Total
Net interest income	$ 130,491	$ 134,409	$ 139,735	$ 148,423	$ 553,058
Provision for loan losses	3,550	5,277	5,156	11,280	25,263
Noninterest income (expense), net	(50,430)	(48,799)	(54,425)	(57,410)	(211,064)
(Provision) benefit for income taxes	(3,688)	1,194	1,823	(3,513)	(4,184)
Net income	$ 72,823	$ 81,527	$ 81,977	$ 76,220	$ 312,547

	2001				
	First	Second	Third	Fourth	Total
Net interest income	$ 113,130	$ 117,468	$ 121,752	$ 131,982	$ 484,332
Provision for loan losses	2,792	3,771	4,518	9,215	20,296
Noninterest income (expense), net	(45,841)	(38,486)	(50,076)	(45,802)	(180,205)
Cumulative effect of a change in accounting principle	(112)	—	112	—	—
(Provision) benefit for income taxes	(1,324)	3,900	7,623	9,211	19,410
Net income	$ 63,061	$ 79,111	$ 74,893	$ 86,176	$ 303,241

Note 20 — Bank Only Financial Data

Condensed financial information of the Bank follows:

Balance Sheet

	December 31,		
	2003	2002	2001
Cash, cash equivalents and investment securities	$ 3,302,661	$ 2,512,937	$ 1,928,577
Loans			
To District Associations	10,591,331	10,033,923	8,916,205
To Others	1,784,020	1,974,118	2,212,605
Total loans	12,375,351	12,008,041	11,128,810
Less: allowance for loan losses	34,168	31,155	25,616
Net loans	12,341,183	11,976,886	11,103,194
Other assets	235,704	211,367	201,634
Total assets	$ 15,879,548	$ 14,701,190	$ 13,233,405
Bonds and notes	$ 14,507,105	$ 13,538,536	$ 12,115,709
Mandatorily redeemable preferred stock	225,000	—	—
Other liabilities	192,911	179,970	163,909
Total liabilities	14,925,016	13,718,506	12,279,618
Mandatorily redeemable preferred stock	—	225,839	225,839
Perpetual preferred stock	150,000	—	—
Capital stock and participation certificates	229,083	249,444	281,803
Retained earnings	601,699	527,673	439,104
Accumulated other comprehensive income (loss)	(26,250)	(20,272)	7,041
Total shareholders' equity	954,532	756,845	727,948
Total liabilities and equity	$ 15,879,548	$ 14,701,190	$ 13,233,405

Statement of Income

	Year Ended December 31,		
	2003	2002	2001
Interest income	$ 528,549	$ 607,411	$ 740,637
Interest expense	284,492	351,751	555,855
Net interest income	244,057	255,660	184,782
Provision for loan losses	2,500	8,000	4,500
Net interest income after provision for loan losses	241,557	247,660	180,282
Noninterest income	9,513	24,271	8,711
Noninterest expenses			
Salaries and employee benefits	23,367	22,507	17,515
Occupancy and equipment	8,552	7,966	7,147
Insurance Fund premium	2,014	632	—
Other operating expenses	13,088	15,985	9,791
Called debt expense	11,736	13,518	9,615
Intra-System financial assistance expenses	13,308	15,458	14,148
Other expenses	1,556	1,732	171
Total noninterest expenses	73,621	77,798	58,387
Net income	$ 177,449	$ 194,133	$ 130,606

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