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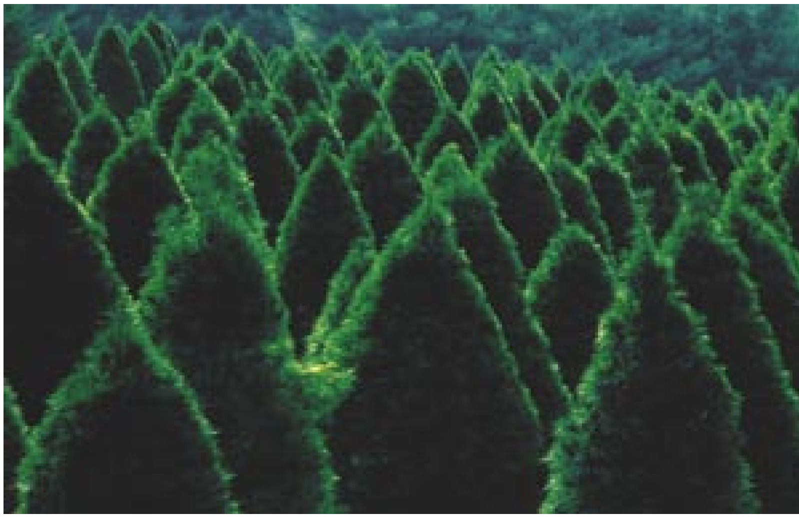
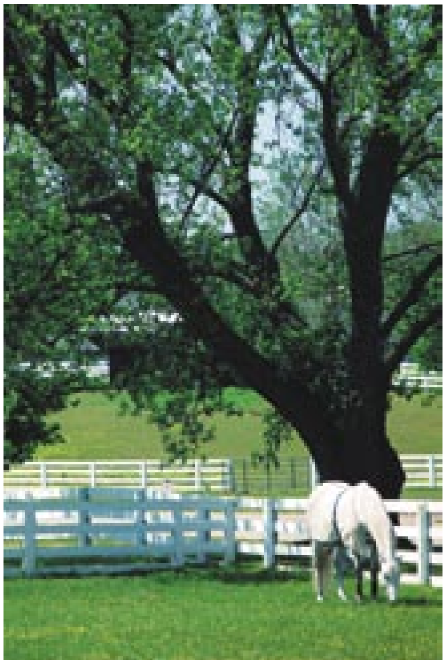
ANNUAL REPORT

Farm Credit

& Country Mortgages

2004





Farm Credit of the Virginias, ACA

2004 Annual Report

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Management

David E. Lawrence ..... President and Chief Executive Officer
C. McCheyne Swortzel ..... Chief Lending Officer
David G. Sauer ..... Chief Financial Officer

Board of Directors

Wallace W. Sanford, III ..... Chairman
William J. Franklin, Jr. ..... Vice Chairman
James H. Addington ..... Director
Ronald L. Bennett ..... Director
Donna M. Brooke – Alt ..... Director
Paul M. House ..... Director
James A. Kinsey ..... Director
Charles B. Leech, IV ..... Director
Ralph L. Puckett ..... Director
Walter L. Schmidlen, Jr. ..... Director
Barry W. Shelor ..... Director
Raymond L. Simms ..... Director
Gregory A. Smith ..... Director
James A. Solomon, Jr. ..... Director
Alfred W. Stephens, Jr. ..... Director
Thomas V. Thacker ..... Director
Joseph W. Wampler ..... Director
John E. Wells ..... Director

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Message from the Chief Executive Officer

Once again it is my pleasure to report that your Farm Credit Association experienced another successful year. This could not be possible without the continued success and support of our customer-owners, Board of Directors, employees and friends in the rural community. Thanks goes to all of you. The Board of Directors and management team remain focused on increasing customer service and stockholder value by not only offering competitive loan products, but also providing you a good return on your investment through the cash rebate program. What other lender is owned by its customers, governed by its customer-directors and puts its profits in your pocket like Farm Credit of the Virginias?

Business results for 2004 exceeded our expectations thanks to your support and use of our services. Earnings for the year were just below the $45 million mark. However, approximately half of the earnings were a “one time event”, reducing the allowance for loan losses. The reduction to the allowance was a result of a refined methodology for calculating the allowance for loan losses, taking into account generally accepted accounting principles and applicable Farm Credit Administration requirements, as well as the Securities and Exchange Commission and Federal Financial Institutions Examination Council guidelines. The refined methodology was primarily based on your Association’s prior loan losses, current loan portfolio conditions, and general economic conditions. Farm Credit of the Virginias prior loan losses have not been significant. It is the practice of the customers to pay your loans on time and the current loan credit quality has never been better.

Because the Association operates as a cooperative, it has been able to pass the low cost of funds on to you, our customers. Additionally, because of the relatively low cost structure, sound loan quality, and solid earnings, the Association has paid to the customers/stockholders a cash rebate in the aggregate amount over $26 million during the past three years. As in the previous years, the customers/stockholders who were active borrowers during 2004 are receiving checks that amount to approximately 15 percent of the interest accrued on their loans during the year.

The annual report is comprised of numbers and in-depth explanations of our 2004 financial results and how they were achieved. We at Farm Credit of the Virginias take our responsibility to the customer-owners very seriously. Of course, our goal is ultimately tied to your goals; when you’re successful, we’re successful. We’ve seen major business collapses at companies while integrity and ethical behavior came under intense scrutiny. I want to assure you that we at Farm Credit of the Virginias will continue to live up to our Values: integrity, learning and constantly improving, and customer focused. By living up to these Values, we will continue to achieve our Vision – to be the lender of choice and be the one others are judged by.

In 2004 and beyond, our focus remains on three top priorities. The first is fostering an aggressive sales and marketing culture with exceptional customer service. The second is ensuring strong profitability through efficient operations, appropriate pricing, and sound financial planning. The third is to maintain a sound credit quality culture through effective credit administration, clear policy and procedural direction, and strong controls.

I hope that you will read through the following financial information and call me if you have any questions pertaining to your Association. I believe that your support and input are vital keys to success.

David E. Lawrence
Chief Executive Officer

March 4, 2005

Report of Management

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

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

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

The consolidated financial statements, in the opinion of management, fairly present the financial condition of the Association. The undersigned certify that the 2004 Annual Report has been prepared in accordance with all applicable statutory or regulatory requirements and that the information contained herein is true, accurate, and complete to the best of our knowledge and belief.

W. W. Sanford, III

Wallace W. Sanford, III
Chairman of the Board

David E. Lawrence

David E. Lawrence
Chief Executive Officer

David G. Sauer

David G. Sauer
Chief Financial Officer

March 4, 2005

Consolidated Five - Year Summary of Selected Financial Data

(UNAUDITED)

(dollars in thousands)	2004	2003	December 31, 2002	2001	2000
Balance Sheet Data					
Cash	$ 2,039	$ 2,628	$ 2,182	$ 2,816	$ 2,567
Loans	1,130,862	1,069,137	1,022,513	902,555	768,278
Less: allowance for loan losses	2,947	23,302	24,505	22,100	20,400
Net loans	1,127,915	1,045,835	998,008	880,455	747,878
Investment in AgFirst Farm Credit Bank	13,524	13,981	15,306	17,873	20,250
Other property owned	—	85	—	—	—
Other assets	28,621	17,959	17,577	17,410	18,960
Total assets	$ 1,172,099	$ 1,080,488	$ 1,033,073	$ 918,554	$ 789,655
Notes payable to AgFirst Farm Credit Bank*	$ 959,297	$ 893,022	$ 848,846	$ 739,790	$ 617,781
Accrued interest payable and other liabilities with maturities of less than one year	31,140	35,956	33,569	22,094	15,136
Total liabilities	990,437	928,978	882,415	761,884	632,917
Capital stock and participation certificates	19,094	19,735	20,469	21,580	23,874
Retained earnings					
Allocated	58,640	58,345	57,904	55,329	55,994
Unallocated	103,928	78,727	78,146	79,761	76,870
Accumulated other comprehensive income (loss)	—	(5,297)	(5,861)	—	—
Total members' equity	181,662	151,510	150,658	156,670	156,738
Total liabilities and members' equity	$ 1,172,099	$ 1,080,488	$ 1,033,073	$ 918,554	$ 789,655
Statement of Income Data					
Net interest income	$ 25,271	$ 24,051	$ 21,664	$ 23,126	$ 23,301
Provision for (reversal of) loan losses	(20,858)	1,180	2,435	1,643	1,000
Noninterest income (expense), net	(1,163)	(4,422)	(3,999)	(3,413)	(5,170)
Net income	$ 44,966	$ 18,449	$ 15,230	$ 18,070	$ 17,131
Key Financial Ratios					
Rate of return on average:					
Total assets	4.06%	1.73%	1.56%	2.12%	2.28%
Total members' equity	27.63%	11.69%	9.30%	11.15%	10.84%
Net interest income as a percentage of average earning assets	2.31%	2.29%	2.25%	2.76%	3.12%
Net chargeoffs (recoveries) to average loans	(0.046)%	0.224%	0.003%	(0.007)%	0.010%
Total members' equity to total assets	15.50%	14.02%	14.58%	17.06%	19.85%
Debt to members' equity (:1)	5.45	6.13	5.86	4.86	4.04
Allowance for loan losses to loans	0.26%	2.18%	2.40%	2.45%	2.66%
Permanent capital ratio	14.68%	14.11%	14.70%	17.37%	19.14%
Total surplus ratio	12.89%	12.19%	12.58%	14.65%	15.04%
Core surplus ratio	10.36%	9.78%	9.12%	11.13%	12.31%
Net Income Distribution					
Estimated patronage refunds:					
Cash dividend	$ 10,011	$ 8,010	$ 8,415	$ 9,845	$ 5,244
Qualified allocated surplus	—	—	—	—	12,237
Nonqualified retained surplus	10,011	9,790	8,415	5,333	—

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

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

(dollars in thousands, except as noted)

GENERAL OVERVIEW

The following commentary reviews the consolidated financial condition and results of operations of Farm Credit of the Virginias, ACA (Association) for the years ended December 31, 2004 and December 31, 2003. This information should be read in conjunction with the consolidated financial statements, notes to the consolidated financial statements and other sections in this annual report.

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

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

The Association obtains funding from AgFirst Farm Credit Bank (the Bank). The Association is materially affected by the financial condition and results of operations of the Bank. Copies of the AgFirst Farm Credit Bank's Quarterly and Annual Reports are on the AgFirst website, *www.agfirst.com,* or may be obtained at no charge by calling 1-800-845-1745, extension 378. Copies of the Association's quarterly reports are available on the Association's website, *www.farmcreditofvirginias.com*, or may be obtained upon request free of charge by calling 1-540-886-3435, extension 620 or writing David Sauer, Farm Credit of the Virginias, P.O. Box 899, Staunton, VA 24402-0899.

ECONOMIC CONDITIONS

The Association covers a large and diverse territory. Given the size and diversity of the area covered by the Association, the economy, in general, has been favorable. Positive influences on the economy continued to be the low interest rates, the continued strength in employment levels and the growth in population. As in the past few years, these positive influences have fueled the demand for land and housing.

Of the major agricultural commodities served by the Association, most experienced a favorable year. The poultry integrators were profitable and the consumer demand for poultry products continued to increase. Some of our customers who have turkey houses were impacted by the closing of a Pilgrim's Pride turkey processing plant in Rockingham County, Virginia. A group of turkey growers who were impacted by the plant closing banded together to form a cooperative to buy and operate the turkey processing plant. The Association has been active in providing credit for the turkey cooperative and continues to work with these members to try to minimize the financial impact of the plant closure and reopening under the new owners.

The dairy industry saw a turn around in milk prices during 2004 after a couple of years of declining milk prices. The increase in milk prices along with favorable weather helped strengthen the finances of dairies operating in our territory. The timber industry continued to experience healthy conditions during 2004. The strength in new housing construction has caused a steady increase in the demand for hardwood products such as hardwood flooring materials and furniture. The cattle industry continued to experience healthy cattle prices as demand for beef remains high and supply continues to be tight. As in most industries, agricultural and timber enterprises continue to implement productivity improvements to reduce the cost of production as a means to increase profitability. For the farm economy as a whole, sizable government payments continue to help strengthen the gross agriculture income for most of the agriculture sectors.

There have been few changes in our market base over the past year. The Association continues to look for opportunities such as buying loan participations. During 2004, the Association continued to target certain segments of our business with hopes of increasing market share. We continued to place greater emphasis on sales and marketing. We saw gains in the housing loan market since we introduced more options such as selling loans into the secondary market. Continued efforts are being made to expand services, increase public knowledge of our services and streamline our current delivery of products to enhance our existing portfolio. Our members recognize the benefits of our profit-sharing program, which reduces their borrowing costs by sharing in the Association's profits. As a result of these efforts, the Association continued to experience increased loan volume throughout its territory.

LOAN PORTFOLIO

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

The gross loan volume of the Association as of December 31, 2004, was $1,130,862, an increase of $61,725 or 5.77 percent as compared to $1,069,137 at December 31, 2003. Net loans outstanding (gross loans net of the allowance for loan losses) on December 31, 2004, were $1,127,915 as compared to $1,045,835 at December 31, 2003. Net loans accounted for 96.23 percent of total assets on December 31, 2004 as compared to 96.79 percent of total assets at December 31, 2003.

The geographic distribution of the loans by volume is as follows:

Branch	12/31/04	12/31/03
Abingdon, VA	5%	4%
Bedford, VA	2	2
Charlottesville, VA	3	4
Chatham, VA	2	2
Clarksburg, WV	3	3
Culpeper, VA	6	6
Elkins, WV	6	4
Gate City, VA	2	2
Halifax, VA	2	2
Harrisonburg, VA	13	14
Leesburg, VA	9	8
Lewisburg, WV	2	2
Lexington, VA	3	3
Oakland, MD	2	2
Orange, VA	5	5
Petersburg, WV	4	4
Ripley, WV	3	3
Roanoke, VA	2	2
Rocky Mount, VA	4	4
Romney, WV	1	1
Verona, VA	5	6
Warrenton, VA	9	9
Wytheville, VA	5	4
Agribusiness	2	1
Participation Loans Purchased	3	6
Participation Loans Sold	(3)	(3)
	100%	100%

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

Loan Type	12/31/04	12/31/03
Long-term farm mortgage	67.6%	66.8%
Production and intermediate-term	20.8	19.7
Rural home	4.2	4.5
Farm-related business	0.8	0.7
Processing and marketing	6.3	4.0
Nonaccrual	0.2	0.7
Participations purchased	3.0	6.2
Less: participations sold	(2.9)	(2.6)
	100.0%	100.0%

The Association's loan portfolio is diversified over a range of agricultural commodities in our region as shown in the table below. Predominant commodities in the portfolio are livestock, field crops, and timber that constitute 62 percent of the entire portfolio on December 31, 2004.

Commodity Group	2004	2003
Livestock	36%	35%
Field Crops	14	12
Timber	12	13
Dairy	9	10
Poultry	9	9
Rural Home	4	4
Tobacco	2	3
Other	14	14
Total	100%	100%

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

Concentration of risk in the loan portfolio, whether by enterprise, individuals, or related parties, is managed through loan participations, underwriting standards, internal lending limits, and sound portfolio management and monitoring practices. As a part of these risk management strategies, the Association has entered into participation agreements with the Bank and System entities. Please refer to Note 4 in the Notes to the Consolidated Financial Statements section of this Annual Report for additional information concerning the loan types and loan portfolio. During 2004, the Association participated in the Federal Agricultural Mortgage Corporation (Farmer Mac) Long-Term Standby Commitment (LTSB program). Under this LTSB program, a loan is repurchased in the event the loan becomes 120 days or more past due, thus allowing the Association to effectively reduce its existing portfolio risk.

The increase in gross and net loan volume during the reporting period was primarily attributed to the continued demand in long-term real estate mortgage loans. The Association continued to see strong demand in farm and rural home loans as long-term mortgage rates remained near historic lows during most of the year. During the second half of the year, short-term interest rates moved up as the Federal Reserve Board increased the federal funds rate from 1.00% to 2.25% at year-end. In addition to the low interest rates, loan activity was also spurred on by the Association's ability to offer competitive loan products that meet members' credit needs and by an increased emphasis on marketing and customer service.

During 2004, the Association bought and sold loan participations within and outside the System. This provides a means for the Association to spread credit concentration risk and realize non-patronage sourced interest and fee income, which may strengthen its capital position. In 2002, the Association joined with three other Farm Credit Associations in the AgFirst District to form AgriCapital group. The AgriCapital group was formed so the associations could pool their purchasing power when dealing with financial institutions that have large participation loans they want to sell. The Association buys the loans and sells an agreed amount to the other members of the AgriCapital group. This process was changed during 2004, so that loans purchased from the Bank are now purchased directly by the associations in the AgriCapital group.

Loan Participations:

	2004	2003
Participations Purchased – FCS Institutions	$ 31,511	$ 63,376
Participations Purchased – Non-FCS Institutions	1,959	2,864
Participations Sold	(33,173)	(27,601)
Total	$ 297	$ 38,639

The Association sells qualified long-term mortgage loans into the secondary market. For the year ended December 31, 2004, the Association originated loans for resale totaling $26,571, which were sold into the secondary market, as compared to $57,490 the previous year. The Association also participates in the Farmer Mac LTSB program. Farmer Mac was established by Congress to provide liquidity to agricultural lenders. At December 31, 2004, the Association had loans amounting to $20,716 which were 100 percent guaranteed by Farmer Mac, compared to none last year. The Association additionally purchased guaranteed portions of loans that are guaranteed by the United States Department of Agriculture. These loans are held for the purposes of reducing interest rate risk and managing surplus short-term funds as allowable under FCA regulations. At December 31, 2004, the balance of these loans (including the unamortized premium) was $1,959, compared to $2,864 at December 31, 2003.

The Association's loan portfolio is divided into performing and high-risk categories. As a part of a system to evaluate the success of a loan, the Association continues to review the credit quality of the loan portfolio on an ongoing basis. A Special Assets Management Department is responsible for servicing loans classified as high-risk. The high-risk assets, including accrued interest, are detailed in the following table:

	12/31/04	12/31/03
High-risk Assets		
Nonaccrual loans	$ 2,511	$ 7,955
Restructured loans	15	20
Accruing loans 90 days past due	—	14
Total high-risk loans	2,526	7,989
Other property owned	—	85
Total high-risk assets	$ 2,526	$ 8,074
Ratios		
Nonaccrual loans to total loans	.22%	0.74%
High-risk assets to total assets	.22%	0.75%

Nonaccrual loans represent all loans where there is a reasonable doubt as to the collection of principal and/or interest under the contractual terms of the loan. Nonaccrual loans decreased $5,444, or 68.43 percent in 2004. The decrease was primarily due to several loans being paid-off, fewer loans being downgraded to nonaccrual status, and continued collection efforts on these accounts. Of the $2,511 in nonaccrual volume at December 31, 2004, $1,058 or 42.13 percent, compared to 4.90 percent at December 31, 2003, was current as to scheduled principal and interest payment, but did not meet all regulatory requirements to be transferred into accrual status.

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

Credit Quality

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

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

	2004	2003
Acceptable & OAEM	98.16%	97.59%
Substandard	1.83	2.41
Doubtful	—	—
Loss	0.01	—
Total	100.00%	100.00%

Allowance for Loan Losses

During 2004, the Association completed its study to further refine the allowance for loan losses methodology taking into account recently issued guidance by the FCA, the System's regulator, as well as the Securities and Exchange Commission (SEC) and Federal Financial Institutions Examination Council. As a result of this study and the resulting refinements in methodology, during the fourth quarter of 2004, the Association recorded a $20,858 reversal of the allowance for loan losses.

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

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

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

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

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

While the reversal had a significant impact on 2004 results of operations and the previously recorded allowance for loan losses, the refinement in methodology is not expected to have a significant impact on comparative results of operations in future periods. Additionally, the refinement in methodology did not have a significant impact on the level of the risk bearing capacity of the Association, generally referred to as "risk funds" (capital plus the allowance for loan losses), which totaled $184,609 million at December 31, 2004 (16.32 percent of Association loans), as compared with $174,812 million at December 31, 2003 (16.35 percent of Association loans).

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

	2004	2003
Allowance for loan losses	$ 2,947	$ 23,302
Provision for (reversal of) loan losses	(20,858)	1,180
Net charge-offs/(recoveries)	(503)	2,383
Allowance for loan losses to loans	0.26%	2.18%
Allowance for loan losses to nonaccrual loans	117.36%	292.92%
Allowance for loan losses to impaired loans	116.67%	291.68%
Net charge-offs/(recoveries) to average loans	(0.046)%	0.224%

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

EMPLOYEE RETIREMENT PLANS

For the year ended December 31, 2004, the Association had contributed $5,462 to the Districtwide defined benefit retirement plan. The Districtwide funding brings the retirement plan's assets to an amount exceeding the Accumulated Benefit Obligation. The contributions and fund performance eliminated the minimum pension liability with $5,790 of the contributions being classified as prepaid retirement expense in other assets on the Consolidated Balance Sheets. Assuming that interest rates and returns on investments remain constant, benefits to the Association in subsequent periods should include improved net income due to lower retirement expense and the elimination of the pension-related charge to accumulated other comprehensive income in the shareholders' equity. See Note 10, Employee Benefit Plans, in the Notes to the Consolidated Financial Statements of this report for further information

RESULTS OF OPERATIONS

Net income for the year ended December 31, 2004, totaled $44,966, an increase of $26,517 or 143.73 percent, as compared to $18,449 for the same period of 2003. Interest income for the year ended December 31, 2004, was $66,336, an increase of $1,952 or 3.03 percent as compared to $64,384 for the same period of 2003. Interest income decreased by $513 for the year ended December 31, 2003, compared to 2002. Major components of the changes in net income for the past two years are outlined in the following table.

Changes in Net Income:

	2004-2003	2003-2002
Net income (prior year)	$ 18,449	$ 15,230
Increase (decrease) in net income due to:		
Interest income	1,952	(513)
Interest expense	(732)	2,900
Net interest income	1,220	2,387
Provision for loan losses	22,038	1,255
Noninterest income	2,711	1,388
Noninterest expense	815	(2,467)
Provision for income taxes	(267)	656
Total changes in income	26,517	3,219
Net income	$ 44,966	$ 18,449

Net interest income increased by $1,220 or 5.07 percent in 2004 as compared to 2003. The primary reasons for this increase was an increase in interest margin on loans and growth in loan volume. Interest income on nonaccrual loans for the twelve months ended December 31, 2004, totaled $264, an increase of $65, compared to $199 during the previous year. Please refer to the Five-Year Summary of Selected Financial Data in this annual report to review key financial ratios pertaining to earnings and net interest income. The sources of change in net interest income are illustrated, as follows:

Change in Net Interest Income:

	Volume*	Rate	Nonaccrual Income	Total
12/31/04 - 12/31/03				
Interest income	$ 2,455	$ (568)	$ 65	$ 1,952
Interest expense	1,687	(955)	—	732
Change in net interest income	$ 768	$ 387	$ 65	$ 1,220
12/31/03 - 12/31/02				
Interest income	$ 5,920	$ (6,465)	$ 32	$ (513)
Interest expense	4,989	(7,889)	—	(2,900)
Change in net interest income	$ 931	$ 1,424	$ 32	$ 2,387

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

During 2004, a reversal of the provision for loan losses of $20,858 was recorded, compared to provision expense of $1,180 during last year. Please refer to the Allowance for Loan Losses section discussed above.

Noninterest income for the period ended December 31, 2004, totaled $12,549, an increase of $2,711 or 27.56 percent, as compared to $9,838 for 2003. The increase in noninterest income was primarily attributed to increases in income received from the Bank of $2,852 and a gain from the sales of two branch offices of $717. The Association received $7,009 in a patronage refund and $3,461 in a special distribution from the Bank for the twelve months ended December 31, 2004 as compared to $6,682 and $936 respectively for 2003. These increases were offset somewhat by a decrease in income from loans sold into the secondary mortgage market.

Noninterest expense decreased $815, or 5.62% for the twelve months ended December 31, 2004, as compared to the same period of 2003. The decrease was primarily attributed to decreases in the salaries and employee benefits of $474 and a decrease in the premium paid to the System Insurance Fund of $714. Salaries and employee benefits decreased mainly due to lower incentive bonuses earned by employees, lower pension expenses and lower health insurance expenses. The insurance fund premium decreased primarily due to a slow down in the System loan volume growth during 2004.

The Association recorded a provision for income taxes of $29 for the twelve months ended December 31, 2004, compared to a benefit of $238 for the same period in 2003.

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

LIQUIDITY AND FUNDING SOURCES

Liquidity

Liquidity management is the process whereby funds are made available to meet all financial commitments including the extension of credit, payment of operating expenses and payment of debt obligations. The Association receives access to funds through its borrowing relationship with the Bank and from income generated by operations. The Association's participation in the Farmer Mac and other secondary market programs provides additional liquidity. Sufficient liquid funds have been available to meet all financial obligations.

Funding Sources

The principal source of funds for the Association is the borrowing relationship established with the Bank through a General Financing Agreement. The General Financing Agreement utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The Bank advances the funds to the Association, creating notes payable to the Bank. The notes payable are segmented into variable rate and fixed rate sections. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association. The total notes payable to the Bank at December 31, 2004, were $959,297 as compared to $893,022 at December 31, 2003. The increase of 7.42 percent during the period is mainly attributable to the increase in loan volume.

Funds Management

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

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

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

CAPITAL RESOURCES

Total members' equity at December 31, 2004, increased 19.90 percent to $181,662, from the December 31, 2003, total of $151,510. The increase was primarily attributed to the increase in earnings.

The Association continued to return members' equity to its members through the cash profit-sharing program (patronage program), retirement of qualified allocated surplus and retirement of stock. A total of $19,443 in members' equity was returned to members in cash during 2004. This included $7,482 in 2003 profit-sharing checks, $10,014 in 1998 qualified allocated surplus and $1,947 in capital stock and participation certificates.

Total capital stock and participation certificates were $19,094 on December 31, 2004, compared to $19,735 on December 31, 2003. This 3.25% decrease is attributed to the refund of stock as loans are paid in full and lower stock requirement on new loans.

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

	2004	2003	Regulatory Minimum
Permanent Capital	14.68%	14.11%	7.00%
Total Surplus	12.89%	12.19%	7.00%
Core Surplus	10.36%	9.78%	3.50%

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

PATRONAGE PROGRAM

Prior to the beginning of any fiscal year, the Association's Board of Directors, by adoption of a resolution, may obligate the Association to distribute to members on a patronage basis all or any portion of available consolidated net earnings of the Association and its subsidiaries for such fiscal year. Refer to Note 8 of the Notes to the Consolidated Financial Statements for more information concerning the patronage distributions.

YOUNG, BEGINNING, AND SMALL FARMERS AND RANCHERS PROGRAM

The Association's mission includes providing sound and constructive credit and related services to young, beginning and small (YBS) farmers and ranchers. Annual marketing goals are established to increase market share of loans to YBS farmers and ranchers. To facilitate credit, we have adopted financing programs and use government guaranteed loan programs. We are actively involved in developing and sponsoring educational opportunities, leadership training, business financial training and insurance services for YBS farmers and ranchers.

YBS farmers and ranchers are defined as:

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

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

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

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

	December 31, 2004	
	Number of Loans	Amount of Loans ($ in 000's)
Young	2,341	$ 127
Beginning	3,757	326
Small	12,688	809,602

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

The Association currently has a high penetration in the young, beginning, and small farmer market. As of December 31, 2004, the Association was doing business with 66.9 percent of the young farmers, 21.5 percent of the beginning farmers, and 4.1 percent of small farmers identified by the 2002 Ag census.

The following strategies and outreach programs have been conducted which allowed the Association to meet its objectives and goals in the young, beginning, and small farmer program:

- Support of 4-H, FFA, and young farmer organizations through sponsorships and donations.
- Sponsor and host seminars on farm transition planning and financial management.
- Sponsor a one-day Young Farmer Institute facilitated by nationally recognized agricultural business consultant, Dr. David Kohl.
- Sponsor and host Dairy Management seminars.

FORWARD LOOKING INFORMATION

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

Disclosure Required by Farm Credit Administration Regulations

Description of Business

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

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

Description of Property

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

Location	Description	Form of Ownership
106 Sangers Lane Augusta County, VA	Administrative	Owned
1237 W. Main Street Abingdon, VA	Branch	Owned
801-B Blue Ridge Ave. Bedford, VA	Branch	Rented *($475 per month)*
1445 E. Rio Road Suite 103 Charlottesville, VA	Branch	Rented *($1,682 per month)*
29 Military Drive Chatham, VA	Branch	Owned
I-79, Exit 115, Rt. 20 S. Clarksburg, WV	Branch	Rented *($1,661 per month)*
409 James Madison Hwy. Culpeper, VA	Branch	Rented *($3,700 per month)*
308 Railroad Ave. Elkins, WV	Branch	Rented *($650 per month)*
241 E. Jackson Street Gate City, VA	Branch	Owned
161 South Main St. Halifax, VA	Branch	Rented *($531 per month)*
306 E. Market St. Harrisonburg, VA	Branch	Owned
27 Fort Evans Rd., NE Leesburg, VA	Branch	Owned
880 North Jefferson St. Lewisburg, WV	Branch	Owned
Rt. 39 Lexington, VA	Branch	Owned
Rt. 219 North Oakland, MD	Branch	Owned
Colonial Shopping Center Orange, VA	Branch	Rented *($1,500 per month)*
106 North Main Street Petersburg, WV	Branch	Owned
Route 33 West Ripley, WV	Branch	Rented *($2,273 per month)*
38 Murray Farm Road Roanoke, VA	Branch	Owned
115 Floyd Avenue Rocky Mount, VA	Branch	Rented *($800 per month)*
452 North High Street Romney, WV	Branch	Owned
1557 Commerce Road Suite 202 Verona, VA	Branch	Rented *($1,731 per month)*
516 Fauquier Road Warrenton, VA	Branch	Owned
660 Pepper's Ferry Road Wytheville,VA	Branch	Owned

Legal Proceedings

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

Description of Capital Structure

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

Description of Liabilities

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

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

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

Senior Officers

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

Senior Officer	Position
David E. Lawrence	Chief Executive Officer
C. McCheyne Swortzel	Chief Lending Officer
David G. Sauer	Chief Financial Officer
Carolyn L. Hite	Corporate Secretary

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

The total amount of compensation earned by the Chief executive officers (CEO) and the highest-paid officers as a group (including the CEOs) during the years ended December 31, 2004, 2003 and 2002, is as follows:

Name of Individual or Number in Group	Year	Annual Salary	Annual Bonus	Deferred Comp.	Total
David E. Lawrence	2004	$195,488	—	$35,773	$231,261
David E. Lawrence	2003	$165,211	—	$33,042	$198,253
Donald L. Shiflet	2003	$ 55,002	$ 13,305	—	$ 68,307*
Donald L. Shiflet	2002	$206,674	$ 41,333	—	$248,007
5	2004	$610,263	$ 62,235	$54,439	$726,937
6	2003	$625,711	$ 74,405	$53,042	$753,158
5	2002	$636,133	$104,522	$22,725	$763,380

* *Donald L. Shiflet retired on March 31, 2003. The Compensation shown is for 3 months.*

In addition to a base salary, all employees except the CEO and internal reviewers can earn additional compensation under an incentive plan. The Association incentive plan adopted for 2004, which has not changed since 2001, is designed to motivate employees to stimulate new business development, increase loan volume, and increase Association's earnings. The incentive plan is based on a combination of individual and association goals. The incentive payments are accrued in the plan year. Payment of the incentive was made in the first quarter of 2005. Employees eligible for the deferred compensation plan may elect to defer the incentive or bonus. The CEO and internal reviewers can receive a bonus at the discretion of the Board of Directors.

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

Directors

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

The aggregate amount of reimbursement for travel, subsistence and other related expenses for all directors as a group was $79,602 for 2004, $70,834 for 2003, and $58,305 for 2002.

Subject to approval by the board, the Association may allow directors honoraria of $300 for attendance at meetings, committee meetings, or special assignments, and $100 for telephone conferences. In addition to the honoraria, directors are paid a quarterly retainer fee of $750. Total compensation paid to directors as a group was $169,600.

The following represents certain information regarding the directors of the Association, including their principal occupation for the past five years:

Wallace W. Sanford, III, Chairman, is a dairy and beef farmer in partnership with his family. He is a director of Maryland-Virginia Milk Producers and serves on the Contingency Planning Committee for Orange-Madison Cooperative. During 2004, he served 11 days at Association board meetings and 26 days in other official activities and was paid $13,900. His term of office is 2004-2006.

William J. Franklin, Jr., Vice Chairman, is a beef cattle farmer. He serves as Chief Executive Officer of the Scott County Telephone Cooperative. He serves on the Virginia Telecommunications Industry Association Board, the Carolina-Virginia's Telephone Association Board, the Scott County Cellular Board, and the Tennessee Industry Telecommunications, LLC Board. During 2004, he served 9 days at Association board meetings and 17 days in other official activities and was paid $10,600. His term of office is 2004-2006.

James H. Addington is the outside director. He is president of Addington Oil Corporation. During 2004, he served 11 days at Association board meetings and 10 days in other official activities and was paid $9,100. His term of office is 2003-2005.

Ronald L. Bennett operates a dairy farm. During 2004, he served 11 days at Association board meetings and 6 days in other official activities and was paid $8,100. His term of office is 2003-2005.

Donna M. Brooke-Alt operates a dairy farm. During 2004, she served 11 days at Association board meetings and 11 days in other official activities and was paid $9,600. Her term of office is 2003-2005.

Paul M. House operates a dairy farm. He serves on the *Ag***First** *Farm Credit Bank* Board. During 2004, he served 9 days at Association board meetings and 3 days in other official activities and was paid $6,400. His term of office is 2002-2004.

James A. Kinsey operates a forage based purebred angus operation. He serves on the CoBank, ACB Board and on the Federal Farm Credit Funding Corporation Board. During 2004, he served 11 days at Association board meetings and 9 days in other official activities and was paid $8,800. His term of office is 2003-2005.

Charles B. Leech, IV is an owner-operator with his family of a dairy farm. He serves on the Rockbridge Farmers Cooperative Board and on the Rockbridge Augusta Dairy Herd Improvement Association Board. During 2004, he served 11 days at Association board meetings and 16 days in other official activities and was paid $11,100. His term of office is 2004-2007.

Ralph L. Puckett operates a cow/calf and feeder cattle operation in addition to raising burley tobacco and hay. He is a Field Sales Associate for Southern States, Inc. and serves on the Washington County Farm Bureau Board. During 2004, he served 11 days at Association board meetings and 16 days in other official activities and was paid $11,100. His term of office is 2004-2006.

Walter L. Schmidlen, Jr. is a dairy and beef farmer and owns a farm machinery dealership. He serves on the AgFirst Farm Credit Bank Board. During 2004, he served 11 days at Association board meetings and 7 days in other official activities and was paid $8,200. His term of office is 2002-2004.

Barry W. Shelor operates a dairy farm. He serves on the Patrick County Farm Bureau Board. During 2004, he served 11 days at Association board meetings and 7 days in other official activities and was paid $8,200. His term of office is 2003-2005.

Raymond L. Simms is a beef cattle farmer. He serves on the Spotsylvania County Farm Bureau Board, the Virginia Cattlemen's Association Board, the Virginia Beef Cattle Improvement Association, and the Tri-County/City Soil and Water Conservation District. He is also the president of Fredericksburg Feeder Calf Association. During 2004, he served 10 days at Association board meetings and 14 days in other official activities and was paid $10,000. His term of office is 2004-2006.

Gregory A. Smith operates a dairy and steer-fattening farm in partnership with his brother. He is president of Ashland Farms, Inc. He is also president of the Culpeper Farmers Cooperative and serves on the Madison Livestock Exchange Board. During 2004, he served 11 days at Association board meetings and 6 days in other official activities and was paid $8,100. His term of office is 2002-2004.

James A. Solomon, Jr. is a tobacco, crop and beef cattle farmer. During 2004, he served 9 days at Association board meetings and 6 days in other official activities and was paid $7,500. His term of office is 2003-2005.

Alfred W. Stephens, Jr. is a dairy farmer. He serves as secretary on the Wythe/Bland DHIA and serves on the Wythe County Farm Bureau Board. During 2004, he served 10 days at Association board meetings and 8 days in other official activities and was paid $8,200. His term of office is 2002-2004.

Thomas V. Thacker is a poultry farmer. He serves on the Cargill Turkey Growers Council. During 2004, he served 11 days at Association board meetings and 14 days in other official activities and was paid $10,500. His term of office is 2003-2005.

Joseph W. Wampler is a general livestock and poultry farmer. During 2004, he served 11 days at Association board meetings and 7 days in other official activities and was paid $8,500. His term of office is 2003-2005.

John E. Wells is a full-time beef farmer. He is a member of the West Virginia Cattlemen's Association, Wirt County Farm Bureau, and is vice president of Jackson County Calf Pool Cooperative. During 2004, he served 11 days at Association board meetings and 18 days in other official activities and was paid $11,700. His term of office is 2002-2004.

Transactions with Senior Officers and Directors

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

Involvement in Certain Legal Proceedings

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

Relationship with Independent Public Accountants

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

Consolidated Financial Statements

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

Copies of the Association's quarterly reports are available upon request free of charge by calling 1-540-886-3435, or writing David Sauer, Farm Credit of the Virginias, P. O. Box 899, Staunton, VA 24402-0899. Information concerning Farm Credit of the Virginias can also be obtained by going to Farm Credit of the Virginias' website at *www.farmcreditofvirginias.com*.

Borrower Information Regulations

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

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

Stockholder Investment

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

Audit Committee Report

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

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

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

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

Based on the considerations referred to above, the Committee recommended to the Board of Directors that the audited financial statements be included in the Association's Annual Report for 2004 and that PwC be appointed independent auditor for the Association for 2005. The foregoing report is provided by the following independent directors, who constitute the Audit Committee:

James H. Addington
Chairman of the Audit Committee

Members of Audit Committee

James A. Kinsey
Walter L. Schmidlen, Jr.
Barry W. Shelor
Raymond L. Simms

Report of Independent Auditors

PRICEWATERHOUSECOOPERS

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

Report of Independent Auditors

March 4, 2005

To the Board of Directors and Stockholders
of Farm Credit of the Virginias, ACA

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

PricewaterhouseCoopers LLP

Consolidated Balance Sheets

(dollars in thousands)	December 31, 2004	December 31, 2003	December 31, 2002
Assets			
Cash	$ 2,039	$ 2,628	$ 2,182
Loans	1,130,862	1,069,137	1,022,513
Less: allowance for loan losses	2,947	23,302	24,505
Net loans	1,127,915	1,045,835	998,008
Accrued interest receivable	6,348	6,180	6,281
Investment in AgFirst Farm Credit Bank	13,524	13,981	15,306
Premises and equipment, net	4,116	3,756	3,628
Other property owned	—	85	—
Deferred tax asset, net	—	21	19
Other assets	18,157	8,002	7,649
Total assets	$ 1,172,099	$ 1,080,488	$ 1,033,073
Liabilities			
Notes payable to AgFirst Farm Credit Bank	$ 959,297	$ 893,022	$ 848,846
Accrued interest payable	3,651	3,734	3,890
Patronage refund payable	10,072	8,098	8,467
Postretirement benefits other than pensions	5,630	4,870	4,155
Minimum pension liability	—	3,769	3,899
Other liabilities	11,787	15,485	13,158
Total liabilities	990,437	928,978	882,415
Commitments and contingencies			
Members' Equity			
Capital stock and participation certificates	19,094	19,735	20,469
Retained earnings			
Allocated	58,640	58,345	57,904
Unallocated	103,928	78,727	78,146
Accumulated other comprehensive income (loss)	—	(5,297)	(5,861)
Total members' equity	181,662	151,510	150,658
Total liabilities and members' equity	$ 1,172,099	$ 1,080,488	$ 1,033,073

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

Consolidated Statements of Income

(dollars in thousands)	For the year ended December 31, 2004	2003	2002
Interest Income			
Loans	$ 66,336	$ 64,384	$ 64,897
Interest Expense			
Notes payable to AgFirst Farm Credit Bank	41,065	40,333	43,233
Net interest income	25,271	24,051	21,664
Provision for (reversal of) loan losses	(20,858)	1,180	2,435
Net interest income after provision for (reversal of) loan losses	46,129	22,871	19,229
Noninterest Income			
Loan fees	679	1,937	1,314
Fees for financially related services	143	113	60
Patronage refund from AgFirst Farm Credit Bank	10,470	7,618	6,921
Gains (losses) from sale of premises and equipment, net	698	—	—
Other noninterest income	559	170	155
Total noninterest income	12,549	9,838	8,450
Noninterest Expense			
Salaries and employee benefits	8,985	9,459	8,191
Occupancy and equipment	1,041	911	941
Insurance Fund premium	552	1,266	289
Other operating expenses	3,105	2,862	2,610
Total noninterest expense	13,683	14,498	12,031
Income before income taxes	44,995	18,211	15,648
Provision (benefit) for income taxes	29	(238)	418
Net income	$ 44,966	$ 18,449	$ 15,230

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

Consolidated Statements of Changes in Members' Equity

(dollars in thousands)	Capital Stock and Participation Certificates	Retained Earnings Allocated	Retained Earnings Unallocated	Accumulated Other Comprehensive Income	Total Members' Equity
Balance at December 31, 2001	$ 21,580	$ 55,329	$ 79,761	$ —	$ 156,670
Comprehensive income					
Net income			15,230		15,230
Minimum pension liability adjustment				(5,861)	(5,861)
Total comprehensive income					9,369
Capital stock/participation certificates issued	1,233				1,233
Capital stock/participation certificates retired	(2,344)				(2,344)
Cash			(8,415)		(8,415)
Nonqualified retained surplus		8,415	(8,415)		—
Retained earnings retired		(7,647)			(7,647)
Distribution adjustment		1,807	(15)		1,792
Balance at December 31, 2002	20,469	57,904	78,146	(5,861)	150,658
Comprehensive income					
Net income			18,449		18,449
Minimum pension liability adjustment				564	564
Total comprehensive income					19,013
Protected borrower equity retired					
Capital stock/participation certificates issued	1,553				1,553
Capital stock/participation certificates retired	(2,287)				(2,287)
Patronage distribution					
Cash			(8,010)		(8,010)
Nonqualified retained surplus		9,790	(9,790)		—
Retained earnings retired		(9,383)			(9,383)
Distribution adjustment		34	(68)		(34)
Balance at December 31, 2003	19,735	58,345	78,727	(5,297)	151,510
Comprehensive income					
Net income			44,966		44,966
Minimum pension liability adjustment				5,297	5,297
Total comprehensive income					50,263
Protected borrower equity retired					
Capital stock/participation certificates issued	1,306				1,306
Capital stock/participation certificates retired	(1,947)				(1,947)
Patronage distribution					
Cash			(10,011)		(10,011)
Nonqualified retained surplus		10,011	(10,011)		—
Retained earnings retired		(10,014)			(10,014)
Distribution adjustment		298	257		555
Balance at December 31, 2004	$ 19,094	$ 58,640	$ 103,928	$ —	$ 181,662

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

Consolidated Statements of Cash Flows

(dollars in thousands)	For the year ended December 31, 2004	2003	2002
Cash flows from operating activities:			
Net income	$ 44,966	$ 18,449	$ 15,230
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation on premises and equipment	495	449	528
Provision for (reversal of) loan losses	(20,858)	1,180	2,435
(Gains) losses from sale of premises and equipment, net	(698)	—	—
Changes in operating assets and liabilities:			
(Increase) decrease in accrued interest receivable	(168)	101	105
(Increase) decrease in deferred tax asset, net	21	(2)	(6)
(Increase) decrease in other assets	(4,858)	(353)	(511)
Increase (decrease) in accrued interest payable	(83)	(156)	59
Increase (decrease) in postretirement benefits other than pensions	760	715	384
Increase (decrease) in minimum pension liability	(3,769)	(130)	3,899
Increase (decrease) in other liabilities	(3,702)	2,891	2,691
Total adjustments	(32,860)	4,695	9,584
Net cash provided by (used in) operating activities	12,106	23,144	24,814
Cash flows from investing activities:			
Net (increase) decrease in loans	(61,222)	(49,092)	(119,988)
(Increase) decrease in investment in AgFirst Farm Credit Bank	457	1,325	2,567
Purchase of premises and equipment, net	(1,029)	(577)	(283)
Proceeds from sale of premises and equipment, net	872	—	—
Proceeds from sale of other property owned	89	—	—
Net cash provided by (used in) investing activities	(60,833)	(48,344)	(117,704)
Cash flows from financing activities:			
Advances on (repayment of) notes payable to AgFirst Farm Credit Bank, net	66,275	44,176	109,056
Capital stock and participation certificates issued	1,306	1,553	1,233
Capital stock and participation certificates retired	(1,947)	(2,287)	(2,344)
Patronage refunds paid	(7,482)	(8,413)	(8,042)
Retained earnings retired	(10,014)	(9,383)	(7,647)
Net cash provided by (used in) financing activities	48,138	25,646	92,256
Net increase (decrease) in cash	(589)	446	(634)
Cash, beginning of period	2,628	2,182	2,816
Cash, end of period	$ 2,039	$ 2,628	$ 2,182
Supplemental schedule of non-cash activities:			
Loans transferred to other property owned	$ —	$ 85	$ —
Cash dividends or patronage distributions declared or payable	10,011	8,010	8,415
Decrease (increase) in accumulated other comprehensive income related to minimum pension liability	5,297	564	(5,861)
Supplemental information:			
Interest paid	$ 41,148	$ 40,489	$ 43,174
Taxes paid, net	138	109	621
Federal tax refunds related to long-term operations	—	7	—

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

Notes to the Consolidated Financial Statements

(dollars in thousands, except as noted)

Note 1 — Organization and Operations

A. **Organization:** Farm Credit of the Virginias, ACA (Association) is a member-owned cooperative which provides credit and credit-related services to or for the benefit of eligible borrowers/stockholders for qualified purposes in forty-six counties in the state of Virginia, forty-eight counties in the state of West Virginia, and two counties in the state of Maryland as follows:

Virginia: Counties of Albemarle, Alleghany, Arlington, Augusta, Bath, Bedford, Bland, Botetourt, Buchanan, Carroll, Craig, Culpeper, Dickenson, Fairfax, Fauquier, Floyd, Franklin, Giles, Grayson, Greene, Halifax, Henry, Highland, Lee, Loudoun, Madison, Montgomery, Nelson, Orange, Patrick, Pittsylvania, Prince William, Pulaski, Rappahannock, Roanoke, Rockbridge, Rockingham, Russell, Scott, Smyth, Spotsylvania, Stafford, Tazewell, Washington, Wise, and Wythe;

West Virginia: Counties of Barbour, Boone, Braxton, Cabell, Calhoun, Clay, Doodridge, Fayette, Gilmer, Grant, Greenbrier, Hampshire, Hardy, Harrison, Jackson, Kanawha, Lewis, Lincoln, Logan, Marion, Mason, McDowell, Mercer, Mineral, Mingo, Monongalia, Monroe, Nicholas, Pendleton, Pleasants, Pocahontas, Preston, Putnam, Raleigh, Randolph, Ritchie, Roane, Summers, Taylor, Tucker, Tyler, Upshur, Wayne, Webster, Wetzel, Wirt, Wood, and Wyoming; and

Maryland: Counties of Allegany and Garrett.

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

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

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

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

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

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

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

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

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

Note 2 — Summary of Significant Accounting Policies

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

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

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

B. **Loans and Allowance for Loan Losses:** Long-term real estate mortgage loans generally have maturities ranging up to 30 years. Substantially all short- and intermediate-term loans for agricultural production or operating purposes have maturities of 10 years or less.

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

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

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

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

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

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

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

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

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

C. **Gains/(Losses) on Loans Held for Sale:** Certain rural home loans originated by the Association are sold on a servicing released basis primarily to the Bank or into the secondary market to unrelated third parties. For loans sold to the Bank, the Association locks into a selling price with the Bank at the time that the Association enters into a commitment to lend to the potential borrower. Gains or losses on sales of mortgage loans are recognized based on the difference between the selling price and the carrying value of the related mortgage loans sold.

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

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

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

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

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

The employees of the Association are eligible to participate in the District's thrift plan (Thrift Plan), which qualifies as a 401(k) plan as defined by the Internal Revenue Code. For employees hired on or prior to December 31, 2002, the Association 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 Association 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. Thrift Plan costs are expensed as funded.

The Association provides certain health care and life insurance benefits to eligible retired employees. Substantially all employees may become eligible for these benefits if they reach early retirement age while working for the Association. Expenses of $1,007, $970 and $675 for the years ended December 31, 2004, 2003 and 2002, respectively, were classified as salaries and employee benefits.

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

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

Note 3 — Refinement of the Allowance for Loan Losses Methodology

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

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

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

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

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

While the $20,858 reversal had a significant impact on 2004 results of operations and the previously recorded allowance for loan losses, the refinement in methodology is not expected to have a significant impact on comparative results of operations in future periods. Additionally, the refinement in methodology did not have a significant impact on the level of the risk bearing capacity of the Association, generally referred to as "risk funds" (capital plus the allowance for loan losses), which totaled $184,609 at December 31, 2004 (16.32 percent of Association loans), as compared with $174,812 at December 31, 2003 (16.35 percent of Association loans).

Note 4 — Loans and Allowance for Loan Losses

A summary of loans follows:

	December 31, 2004	2003	2002
Long-term farm mortgage	$ 764,019	$ 714,373	$ 665,878
Production and intermediate-term	235,537	210,076	211,610
Rural home	47,193	47,667	49,161
Farm related business	9,493	7,438	8,648
Processing and marketing	71,513	42,767	41,360
Sales contracts	299	222	147
Nonaccruals	2,511	7,955	10,351
Plus: participations purchased	33,470	66,240	51,882
Less: participations sold	(33,173)	(27,601)	(16,524)
Total	$ 1,130,862	$ 1,069,137	$1,022,513

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

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

Commodity Type	December 31, 2004	2003	2002
Livestock	36%	35%	33%
Field Crops	14	12	12
Timber	12	13	14
Dairy	9	10	9
Poultry	9	9	10
Rural Home	4	4	5
Tobacco	2	3	3
Other	14	14	14
Total	100%	100%	100%

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

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

The following table presents information relating to impaired loans.

	December 31, 2004	2003	2002
Nonaccrual loans:			
Current as to principal and interest	$ 1,058	$ 390	$ 2,321
Past due	1,453	7,565	8,030
Total nonaccrual loans	2,511	7,955	10,351
Impaired accrual loans:			
Restructured accrual loans	15	20	24
Accrual loans 90 days or more past due	—	14	2,045
Total impaired accrual loans	15	34	2,069
Total impaired loans	$ 2,526	$ 7,989	$ 12,420

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

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

	Year Ended December 31, 2004	2003	2002
Interest income recognized on nonaccrual loans	$ 264	$ 199	$ 167
Interest income on impaired accrual loans	73	119	128
Interest income recognized on impaired loans	$ 337	$ 318	$ 295

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

	2004	2003	2002
Impaired loans with related allowance	$ 710	$ 5,018	$ 57
Impaired loans with no related allowance	1,816	2,971	12,363
Total impaired loans	$ 2,526	$ 7,989	$ 12,420
Allowance on impaired loans	$ 201	$ 984	$ 52

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

	2004	2003	2002
Average impaired loans	$ 7,167	$ 11,097	$ 3,917

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

Interest income which would have been recognized under the original loan terms	$ 825
Less: interest income recognized	264
Foregone interest income	$ 561

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

	Year Ended December 31, 2004	2003	2002
Balance at beginning of year	$ 23,302	$ 24,505	$ 22,100
Provision for loan losses	—	1,180	2,435
Nonrecurring provision for loan losses reversal*	(20,858)	—	—
Loans charged off	(285)	(2,438)	(30)
Recoveries	788	55	—
Balance at end of year	$ 2,947	$ 23,302	$ 24,505

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

	2004	2003	2002
Ratio of net charge-offs/(recoveries) during the period to average loans outstanding during the period	(0.046)%	0.224%	0.003%

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

To mitigate the risk of loan losses, the Association may enter into long-term standby commitments 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 Association the right to sell the loans identified in the agreements to Farmer Mac in the event of default, subject to certain conditions. The balance of loans under long-term standby commitments was $20,716 at December 31, 2004 and none at December 31, 2003 and 2002. Fees paid to Farmer Mac for such commitments totaled $44 at December 31, 2004 and none for the years ended December 31, 2003 and 2002. These amounts are classified as noninterest expense.

Note 5 — Investment in AgFirst Farm Credit Bank

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

Note 6 — Premises and Equipment

Premises and equipment consisted of the following:

	December 31, 2004	2003	2002
Land	$ 1,353	$ 1,108	$ 1,008
Buildings and improvements	3,428	3,492	3,304
Furniture and equipment	3,635	3,362	3,124
	8,416	7,962	7,436
Less: accumulated depreciation	4,300	4,206	3,808
Total	$ 4,116	$ 3,756	$ 3,628

Note 7 — Notes Payable to AgFirst Farm Credit Bank

The Association's indebtedness to the Bank represents borrowings by the Association to fund its loan portfolio. This indebtedness is collateralized by a pledge of substantially all of the Association's assets and the terms of the revolving lines of credit are governed by a general financing agreement. Interest rates on both variable and fixed rate notes payable are generally established loan-by-loan based on the Bank's marginal cost of funds, capital position, operating costs and return objectives. The interest rate is periodically adjusted by the Bank based upon agreement between the Bank and Association. The weighted average interest rates on the variable rate notes were 3.39 percent for LIBOR-based loans, 3.17 percent for Prime-based loans, and the weighted average remaining maturities were 6.7 years and 4.2 years, respectively, at December 31, 2004. The weighted average interest rate on the fixed rate and adjustable rate mortgage (ARM) notes payable which are match funded by the Bank was 4.73 percent and the weighted average remaining maturity was 10.7 years at December 31, 2004. The weighted average interest rate on all interest-bearing notes payable was 4.34 percent and the weighted average remaining maturity was 9.4 years at December 31, 2004.

Variable rate and fixed rate notes payable represent approximately 13.60 percent and 86.40 percent, respectively, of total notes payable at December 31, 2004.

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

Note 8 — Members' Equity

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

A. **Capital Stock and Participation Certificates**

In accordance with the Farm Credit Act and the Association's capitalization bylaws, each borrower is required to invest in Class C Common Stock for agricultural loans, or Participation Certificates in the case of rural home and farm related business loans, as a condition of borrowing. The initial borrower investment, through either purchase or transfer, must be a minimum of two percent of the loan amount or $1 thousand, or such higher amount as determined by the Board. The Board of Directors may increase the amount of investment if necessary to meet the Association's capital needs. Loans designated for sale or sold into the Secondary Market on or after April 16, 1996 will have no voting stock or participation certificate purchase requirement if sold within 180 days following the date of designation.

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

B. **Regulatory Capitalization Requirements and Restrictions**

FCA's capital adequacy regulations require the Association to achieve permanent capital of seven percent of risk-adjusted assets and off-balance-sheet commitments. Failure to meet the seven percent capital requirement can initiate certain mandatory and possibly additional discretionary actions by FCA that, if undertaken, could have a direct material effect on the Association's financial statements. The Association is prohibited from reducing permanent capital by retiring stock or making certain other distributions to shareholders unless prescribed capital standards are met. FCA regulations also require that additional minimum standards for capital be achieved. These standards require all System institutions to achieve and maintain ratios as defined by FCA regulations. These required ratios are total surplus as a percentage of risk-adjusted assets of seven percent and of core surplus as a percentage of risk-adjusted assets of three and one-half percent. The Association's permanent capital, total surplus and core surplus ratios at December 31, 2004 were 14.68 percent, 12.89 percent and 10.36 percent, respectively.

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

C. **Description of Equities**

The Association is authorized to issue or have outstanding Class D Preferred Stock, Classes A and C Common Stock, Participation Certificates and such other classes of equity as may be provided for in amendments to the bylaws in such amounts as may be necessary to conduct the Association's business. All stock and participation certificates have a par or face value of five dollars ($5.00) per share.

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

		Shares Outstanding	
Class	**Protected**	**Number**	**Aggregate Par Value**
A Common/Nonvoting	No	408,509	$ 2,043
C Common/Voting	No	3,180,996	15,905
Participation Certificates/Nonvoting	No	229,269	1,146
Total Capital Stock and Participation Certificates		3,818,774	$ 19,094

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

Retained Earnings

The Association maintains an unallocated retained earnings account and an allocated retained earnings account. The minimum aggregate amount of these two accounts is determined by the Board. At the end of any fiscal year, if the retained earnings accounts otherwise would be less than the minimum amount determined by the Board as necessary to maintain adequate capital reserves to meet the commitments of the Association, the Association shall apply earnings for the year to the unallocated retained earnings account in such amounts as may be determined necessary by the Board. Unallocated retained earnings are maintained for each borrower to permit liquidation on a patronage basis.

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

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

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

At December 31, 2004, allocated members' equity consisted of $22,952 of qualified surplus and $35,688 of nonqualified retained surplus.

Patronage Distributions

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

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

The patronage distributions accrued at year-end are based on estimates. The actual amounts distributed may vary from these estimates. Differences are reflected as distribution adjustments in the Consolidated Statements of Changes in Members' Equity.

Dividends

Dividends may be paid on stock and participation certificates as determined by the Board's resolution. Dividends may not be paid on common stock and participation certificates during any fiscal year with respect to which the Association has obligated itself to distribute earnings on a patronage basis pursuant to the bylaws. The rate of dividend paid on Class D Preferred Stock for any fiscal year may not be less than the rate of dividend paid on common stock or participation certificates for such year. All dividends shall be paid on a per share basis. Dividends on common stock and participation certificates shall be noncumulative without preference between classes.

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

Transfer

Common stocks and participation certificates may be transferred to persons or entities eligible to purchase or hold such equities under the bylaws. Class D Preferred Stock may be transferred in the manner set forth in the resolution authorizing its issuance.

Impairment

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

1. Nonqualified allocated members equity beginning with the most recent allocation
2. Qualified allocated members equity beginning with the most recent allocation
3. Classes A and C Common Stock and Participation Certificates
4. Class D Preferred Stock

Liquidation

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

1. Holders of Class D Preferred Stock until an amount equal to the aggregate par value of shares of Class D Preferred Stock then outstanding has been distributed to the holders;
2. Holders of Class A Stock, Class C Stock, and Participation Certificates pro rata in proportion to the number of shares or units each such class of stock and participation certificates then outstanding until an amount equal to the aggregate par value (or face value) of such shares or units has been distributed to the holders;
3. Holders of Allocated Surplus to the extent evidenced by qualified written notices of allocation, pro rata, on the basis of the oldest allocations first, until an amount equal to the total account has been distributed to such holders;
4. Holders of Allocated Surplus to the extent evidenced by nonqualified written notice of allocation, pro rata, on the basis of the oldest allocations first, until an amount equal the total account has been distributed to such holders;
5. Any remaining assets of the Association after such distributions shall be distributed to Patron, past and present, in proportion to which the aggregate patronage of each such Patron bears to the total patronage of all such parties insofar as practicable, unless as otherwise provided by law.

D. **Other Comprehensive Income (Loss)**

The Association reports other comprehensive income (loss) in its Statement of Changes in Members' Equity. For the years ended December 31, 2003 and 2002, other comprehensive income (loss) is related to the minimum pension liability recorded as a result of the funded status of the underlying plan. During 2004, the District Associations funded the pension plans sufficiently to eliminate the pension-related charge to other comprehensive income (loss) at December 31, 2004. See Note 10 for further information.

Note 9 — Income Taxes

The provision (benefit) for income taxes follows:

	Year Ended December 31, 2004	2003	2002
Current:			
Federal	$ —	$ (279)	$ 467
State	(7)	43	(43)
	(7)	(236)	424
Deferred:			
Federal	30	(2)	(5)
State	6	—	(1)
	36	(2)	(6)
Total provision (benefit) for income taxes	$ 29	$ (238)	$ 418

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

	December 31, 2004	2003	2002
Federal tax at statutory rate	$ 15,298	$ 6,192	$ 5,320
State tax, net	(1)	29	(29)
Reversal of allowance for loan losses	(2,282)	—	—
Patronage distributions	(3,248)	(1,593)	(1,445)
Tax-exempt FLCA earnings	(10,098)	(4,478)	(3,767)
Other	360	(388)	339
Provision (benefit) for income taxes	$ 29	$ (238)	$ 418

Deferred tax assets and liabilities result from the following at:

	December 31, 2004	2003	2002
Postretirement benefits other than pensions	$ 53	$ 87	$ 100
Gross deferred tax assets	53	87	100
Future Bank equity redemption	(3)	(3)	(3)
Annual leave	18	13	18
Pensions	(42)	(45)	(55)
Depreciation	(5)	(5)	(5)
Gross deferred tax liability	(68)	(66)	(81)
Net deferred tax asset (liability)	$ (15)	$ 21	$ 19

At December 31, 2004, deferred income taxes have not been provided by the Association on approximately $1.6 million of patronage refunds received from the Bank prior to January 1, 1993. Such refunds, distributed in the form of stock, are subject to tax only upon conversion to cash. The tax liability related to future conversions is not expected to be material.

Note 10 — Employee Benefit Plans

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

At December 31, 2004, the fair value of the plan assets of the District's defined benefit plan exceeded the Accumulated Benefit Obligation, while at December 31, 2003 and 2002, the Accumulated Benefit Obligation (ABO) of the District's defined benefit plan exceeded the fair value of plan assets. The fair value of the plan assets and the ABO were measured as of September 30, 2004. At December 31, 2003 and 2002, the Association's allocated amount of the minimum pension liability was recorded in the Consolidated Balance Sheets in the amount of the excess of the ABO over the fair value of plan assets. In conjunction with the minimum pension liability, accumulated other comprehensive loss was $5,297 and $5,861 at December 31, 2003 and 2002, respectively. The impact on deferred taxes was not significant.

In addition, supplemental retirement benefits and deferred compensation options are provided to certain key employees under a supplemental defined benefit executive plan and the AgFirst Farm Credit District Deferred Compensation Plan, which are not qualified under the Internal Revenue Code. As nonqualified plans, assets have been allocated and separately invested for this plan but are not considered in the assets of the plan as they are not isolated from the general creditors of the Association.

The Association participates in a Districtwide Thrift Plan. For employees hired on or prior to December 31, 2002, the Association 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 Association 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.

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

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

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

	2004	2003	2002
Pension	$1,218	$1,325	$ 837
Thrift/deferred compensation	200	188	179
Other postretirement benefits	1,007	970	675
Total	$2,425	$2,483	$1,691

As of December 31, 2004, the Association had contributed $5,462 to the Districtwide defined benefit retirement plan, which was sufficient to meet its accumulated benefit obligation. The contributions eliminated the minimum pension liability and the pension-related charge to accumulated other comprehensive income (OCI) in shareholders' equity. As a result of the funding and the reclassification of the OCI, the Association ended 2004 with $5,790 in prepaid retirement expense in other assets on the consolidated balance sheets.

Note 11 — Intra-System Financial Assistance

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

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

Note 12 — Related Party Transactions

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

Total loans to such persons at December 31, 2004 amounted to $4,366. During 2004, $3,225 of new loans were made and repayments totaled $2,240. In the opinion of management, none of these loans outstanding at December 31, 2004 involved more than a normal risk of collectibility.

Note 13 — Commitments and Contingencies

The Association has various commitments outstanding and contingent liabilities.

The Association may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of its borrowers and to manage their exposure to interest-rate risk. These financial instruments include commitments to extend credit and/or commercial letters of credit. The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the financial statements. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. Commercial letters of credit are agreements to pay a beneficiary under conditions specified in the letter of credit. Commitments and letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. At December 31, 2004, $161,945 of commitments to extend credit and $1,949 of standby letters of credit were outstanding.

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

The Association also participates in standby letters of credit to satisfy the financing needs of its borrowers. These letters of credit are irrevocable agreements to guarantee payments of specified financial obligations. Outstanding standby letters of credit have expiration dates ranging from August 26, 2005 to October 29, 2010.

Note 14 — Disclosures About Fair Value of Financial Instruments

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

Quoted market prices are generally not available for certain System financial instruments, as described below. Accordingly fair values are based on judgments regarding anticipated cash flows, future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates involve uncertainties and matters of judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

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

	December 31, 2004		December 31, 2003	
	Carrying Amount	**Estimated Fair Value**	**Carrying Amount**	**Estimated Fair Value**
Financial assets:				
Cash	$ 2,039	$ 2,039	$ 2,628	$ 2,628
Loans	$ 1,130,862	$ 1,132,847	$ 1,069,137	$ 1,075,084
Allowance for loan losses	2,947	—	23,302	—
Loans, net	$ 1,127,915	$ 1,132,847	$ 1,045,835	$ 1,075,084
Financial liabilities:				
Notes payable to AgFirst Farm Credit Bank	$ 959,297	$ 944,317	$ 893,022	$ 879,346

	December 31, 2002	
	Carrying Amount	**Estimated Fair Value**
Financial assets:		
Cash	$ 2,182	$ 2,182
Loans	$ 1,022,513	$ 1,049,034
Allowance for loan losses	24,505	—
Loans, net	$ 998,008	$ 1,049,034
Financial liabilities:		
Notes payable to AgFirst Farm Credit Bank	$ 848,846	$ 859,341

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

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

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

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

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

The carrying value of accrued interest approximates its fair value.

C. **Investment in AgFirst Farm Credit Bank:** Estimating the fair value of the Association's investment in the Bank is not practicable because the stock is not traded. As described in Note 5, the net investment is a requirement of borrowing from the Bank and is carried at cost plus allocated equities in the accompanying balance sheet. The Association owns 8.06 percent of the issued stock of the Bank as of December 31, 2004 net of any reciprocal investment. As of that date, the Bank's assets totaled $16.9 billion and shareholders' equity totaled $1,024 million. The Bank's earnings were $180 million during 2004.

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

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

Note 15 — Quarterly Financial Information (Unaudited)

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

	2004				
	First	**Second**	**Third**	**Fourth**	**Total**
Net interest income	$ 5,990	$ 6,134	$ 6,448	$ 6,699	$ 25,271
Provision for (reversal of) loan losses	—	—	—	(20,858)	(20,858)
Noninterest income (expense), net	(1,433)	(938)	(1,067)	2,275	(1,163)
Net income (loss)	$ 4,557	$ 5,196	$ 5,381	$ 29,832	$ 44,966

	2003				
	First	**Second**	**Third**	**Fourth**	**Total**
Net interest income	$ 5,721	$ 6,074	$ 6,203	$ 6,053	$ 24,051
Provision for (reversal of) loan losses	514	666	—	—	1,180
Noninterest income (expense), net	(1,230)	(1,284)	(1,185)	(723)	(4,422)
Net income (loss)	$ 3,977	$ 4,124	$ 5,018	$ 5,330	$ 18,449

	2002				
	First	**Second**	**Third**	**Fourth**	**Total**
Net interest income	$ 4,874	$ 5,055	$ 5,698	$ 6,037	$ 21,664
Provision for (reversal of) loan losses	600	623	601	611	2,435
Noninterest income (expense), net	(1,035)	(1,345)	(1,543)	(76)	(3,999)
Net income (loss)	$ 3,239	$ 3,087	$ 3,554	$ 5,350	$ 15,230