
PEE DEE FARM CREDIT, ACA

2003 ANNUAL REPORT

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Management

Jasper W. Shuler	President and Chief Executive Officer
Kathy S. Heustess	Chief Financial Officer
William H. Wise, Jr.....	Chief Operating Officer
Richard H. Horn.....	Chief Credit Officer

Board of Directors

Dale W. Player	Chairman
Harry B. DuRant	Vice Chairman
DuPree Atkinson.....	Director
W. Edwin Dargan, Jr.....	Director
Dr. Timothy W. Koch.....	Director
Jimmy Poston.....	Director
Harold C. Stowe.....	Director
James M. Ward	Director

Message from the President

Strong performance across all segments of our association in 2003 enabled Pee Dee Farm Credit to achieve exceptional growth in both sales and earnings. In 2003, the Association's earnings exceeded \$4.7 million, which translates into an ROE of 14.63 percent and a ROA of 1.95 percent. We distributed \$1.9 million of the 1997 allocated surplus in the fourth quarter of 2003. In April of 2004, we will pay 100 percent of patronage-sourced earnings from 2003 — 40 percent in cash. We will continue our strong value adding patronage program to our stockholders with our cooperative structure remaining one of our guiding principles.

As further evidence of the association's financial strength, credit quality remained high at 98.41 percent acceptable, delinquencies low at .60 percent and our capital position is holding strong at 16.01 percent, more than double the regulatory minimum of 7 percent. We grew our portfolio's average daily balance (ADB) by \$30 million, exceeding our ADB for 2002. The participations market contributed much to the growth of our portfolio in 2003. Farm Related Services fee income exceeded budget in 2003 with crop and life insurance income leading the way reaching over \$450,000. I commend account officers, Don Boice and Jim Wooten, for their outstanding sales results in this area in 2003.

As we plan for the future and the transition of the Pee Dee area of South Carolina we believe there will be fewer farmers, but growth in corporate agriculture and agribusiness markets. Specialized markets including the areas of biotechnology, bioengineering, nutraceuticals, pharmaceuticals, and alternative energy sources will play a prominent role in our future. Population increase in rural areas will cause migration further away from farming roots. This urban sprawl will result in a growth in the lifestyle/mini-farm market, recreational property market, and other similar niche markets. Pee Dee Farm Credit has positioned itself to compete in these areas by adding our home mortgage division *Carolina Home and Land*, which has recently completed its first full year of operation.

We face the future with optimism and commitment to all of our business segments because we see many opportunities for continued growth and development. We are constantly making enhancements to serve our changing customer needs; maintain our excellent reputation in the community; provide more customer conveniences; expand our related services; continue various product delivery channels; emphasize speed of service; and utilize all available technology. In 2004 and beyond, the Internet will become a major channel for information and the delivery of products and services, as well as a method by which the association will conduct business.

We continue to promote Account Access whereby customers can view their account information on-line anytime. And this spring we will roll out an on-line application form for the Carolina Home and Land Division. We've added value by expanding and improving our products and services and increasing the efficiency and effectiveness of our operation. To reduce costs we continue to streamline our processes. Employees like Faye Hanna showed her dedication to this by being the first account officer to load her accounts into our electronic filing system (ELF);

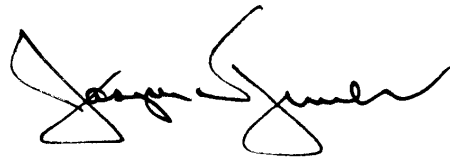
and Billy Scarborough, credit analyst, expressed his dedication through his thorough validation and testing of AgScore, a credit scoring system for ag loans. Account officers and credit officers are utilizing the financial analysis software, ACE, to assist them in decision-making.

Throughout 2003 we were able to outsource several areas including the finance, operations and credit reviews; appraisal services and database management. We also found more ways to meet the needs of our customers with new services like Money Concepts, an outstanding financial planning program. Our involvement in Young, Beginning and Small Farmer programs are stronger than ever. Along with our active participation in all area young farmer chapters, we continue to sponsor the Darlington County Young Farmer Agricultural Issues Seminar and Dinner.

I'd like to acknowledge Pee Dee Farm Credit's "*people capital.*" With the right staff in the right positions, we can own the markets in which we choose to compete. Training and development are top priorities because the results foster confidence and commitment that is the difference between a job and a career. We also realize a company won't succeed without people who are also succeeding. Frances Rogers, accountant, is a perfect example. Frances recently graduated from South Carolina Bankers' School with honors.

The strength of our leadership with their diversity of experiences and backgrounds are key to our continued success and solid performance. We were honored to welcome two new appointed directors to our board in 2003, Dr. Timothy Koch and Harold Stowe. Both bring tremendous financial and industry knowledge to our distinguished group. I'm forever grateful for our board of directors' efforts and continued allegiance.

In closing, I am encouraged about the future of Pee Dee Farm Credit and I'm confident we are well positioned for the future. There is much left to be done, and much work in progress. Together, our board of directors, management team, employees and each of you as members share the responsibility of ensuring the continued success of Pee Dee Farm Credit. We have a shared vision, our goals remain focused and our performance progressive. Rarely is success a matter of chance. We have prepared for a successful future. Best wishes for a prosperous 2004.



Jasper W. Shuler
President and Chief Executive Officer

February 19, 2004

Report of Management

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

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

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

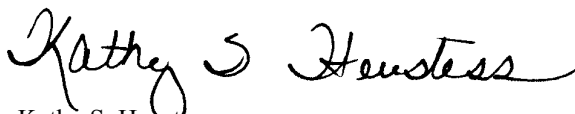
The consolidated financial statements, in the opinion of management, fairly present the financial condition of the Association. The undersigned certify that the 2003 Annual Report has been prepared in accordance with all applicable statutory or regulatory requirements and that the information contained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



Dale W. Player
Chairman of the Board



Jasper W. Shuler
Chief Executive Officer



Kathy S. Heustess
Chief Financial Officer

February 19, 2004

Consolidated Five - Year Summary of Selected Financial Data

(UNAUDITED)

<i>(dollars in thousands)</i>	2003	2002	December 31, 2001	2000	1999
Balance Sheet Data					
Cash	\$ 2	\$ 2	\$ 3	\$ 3	\$ 3
Loans	230,091	240,891	223,041	152,268	149,484
Less: allowance for loan losses	5,446	5,320	5,459	5,447	5,531
Net loans	224,645	235,571	217,582	146,821	143,953
Investment in other Farm Credit institutions	3,774	4,212	4,216	4,209	4,209
Other assets	5,278	5,537	6,113	6,016	5,965
Total assets	<u>\$ 233,699</u>	<u>\$ 245,322</u>	<u>\$ 227,914</u>	<u>\$ 157,049</u>	<u>\$ 154,130</u>
Notes payable to AgFirst Farm Credit Bank*	\$ 193,623	\$ 206,383	\$ 190,993	\$ 120,470	\$ 118,129
Accrued interest payable and other liabilities with maturities of less than one year	9,429	9,017	5,038	5,209	5,142
Total liabilities	<u>203,052</u>	<u>215,400</u>	<u>196,031</u>	<u>125,679</u>	<u>123,271</u>
Protected borrower equity	701	818	1,053	1,194	1,341
Capital stock and participation certificates	1,155	1,188	1,194	1,152	1,156
Retained earnings					
Allocated	16,653	15,735	15,124	14,577	14,016
Unallocated	14,618	14,865	14,512	14,447	14,346
Accumulated other comprehensive income (loss)	(2,480)	(2,684)	—	—	—
Total members' equity	<u>30,647</u>	<u>29,922</u>	<u>31,883</u>	<u>31,370</u>	<u>30,859</u>
Total liabilities and members' equity	<u>\$ 233,699</u>	<u>\$ 245,322</u>	<u>\$ 227,914</u>	<u>\$ 157,049</u>	<u>\$ 154,130</u>
Statement of Income Data					
Net interest income	\$ 6,470	\$ 6,516	\$ 6,550	\$ 6,621	\$ 6,304
Provision for (reversal of) loan losses	—	1,150	150	—	—
Noninterest income (expense), net	(1,711)	(1,130)	(1,584)	(2,051)	(1,567)
Net income	<u>\$ 4,759</u>	<u>\$ 4,236</u>	<u>\$ 4,816</u>	<u>\$ 4,570</u>	<u>\$ 4,737</u>
Key Financial Ratios					
Rate of return on average:					
Total assets	1.95%	1.72%	2.45%	2.85%	2.87%
Total members' equity	14.63%	12.54%	15.20%	14.19%	15.39%
Net interest income as a percentage of average earning assets	2.71%	2.71%	3.42%	4.26%	3.92%
Net chargeoffs (recoveries) to average loans	(0.05)%	0.53%	0.07%	0.05%	0.03%
Total members' equity to total assets	13.11%	12.20%	13.99%	19.97%	20.02%
Debt to members' equity (:1)	6.63	7.20	6.15	4.01	3.99
Allowance for loan losses to loans	2.37%	2.21%	2.45%	3.58%	3.70%
Permanent capital ratio	16.01%	13.53%	15.52%	19.13%	17.71%
Total surplus ratio	15.38%	12.49%	14.85%	18.43%	16.88%
Core surplus ratio	11.80%	10.06%	12.64%	15.61%	13.91%
Net Income Distribution					
Estimated patronage refunds:					
Cash dividend	\$ 1,997	\$ 1,590	\$ 1,868	\$ 1,809	\$ 1,890
Qualified allocated retained earnings	2,075	1,741	2,802	2,714	2,835
Nonqualified allocated retained earnings	921	643	—	—	—

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

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

(dollars in thousands, except as noted)

The following commentary reviews the financial condition and results of operations of Pee Dee Farm Credit (Association) for the years ended December 31, 2003 and December 31, 2002. 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 agricultural economy of the territory serviced by the Association which includes the major commodities of tobacco, cotton, forestry and broilers; continued to improve in most sectors. Although the region experienced some adverse weather conditions during the year in parts of the territory, overall crop yields in the region were good. Also, prices were good for the major commodities produced in the region, especially cotton, grains, eggs, beef, swine and poultry. Real estate values continue to trend upward. The future of the tobacco industry remains uncertain with the ongoing impact of political, regulatory, legal and marketing issues. Association management will be monitoring the tobacco situation closely and will be actively managing the loan portfolio. In general, 2003 has been a very successful year for the Association.

There has been significant change in our market base over the past year; with the Association buying and selling loan participations as well as the Association's involvement in Farmer Mac guarantee programs. During 2003, the Association targeted certain segments of our business with hopes of increasing market share. Continued efforts are being made to expand services, increase public knowledge of our services and streamline our current delivery of products to enhance our existing portfolio.

Effective January 1, 2002, pursuant to a plan of restructuring approved by the Farm Credit Administration (FCA) and Association shareholders, the Association reorganized its existing organizational structure. Pursuant to this restructuring, a Federal Land Credit Association (FLCA) and Production Credit Association (PCA) were formed as wholly owned subsidiaries of the Association. The formation of these subsidiaries enables the Association to take advantage of the tax-exempt status of net income from long-term mortgage operations of the FLCA. Please refer to Note 1 of the Notes to the Consolidated Financial Statements in this Annual Report for additional information relating to the Association organization.

LOAN PORTFOLIO

The Association provides funds to farmers, rural homeowners, and farm-related businesses for financing of short and intermediate-term loans and long-term real estate mortgage loans. The geographic distribution of the loans is as follows:

State	12/31/03	12/31/02
South Carolina	75.5%	80.2%
California	—	.6
Florida	16.8	15.7
Georgia	2.6	.9
Kansas	.1	—
Maryland	.8	.7
New York	.3	.2
North Carolina	1.9	1.7
Tennessee	1.2	—
Texas	.7	—
Virginia	.1	—
	100.0%	100.0%

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

Loan Type	12/31/03	12/31/02
Long-term farm mortgage	27.74%	25.06%
Production and intermediate-term	47.84	52.17
Rural home	4.66	4.72
Farm-related business	2.85	3.31
Basic processing	15.57	15.28
Nonaccrual	.51	.76
Sales contracts/investments	2.22	.15
Participations purchased	21.31	22.97
Less: participations sold	(22.70)	(24.42)
	100.00%	100.00%

The Association's loan portfolio is diversified over a range of agricultural commodities in our region. Predominant commodities in the portfolio are livestock, poultry, tobacco, forestry, and row crops that constitute over 82 percent of the entire portfolio. Please refer to Note 3 in the Notes to the Consolidated Financial Statements section of this Annual Report for additional information concerning the loan types and loan portfolio.

The gross loan volume of the Association as of December 31, 2003, was \$230,091, a decrease of \$10,800 or 4.48 percent as compared to \$240,891 at December 31, 2002. Net loans outstanding on December 31, 2003, were \$224,645 as compared to \$235,571 at December 31, 2002. Net loans accounted for 96.13 percent of total assets on December 31, 2003 as compared to 96.03 percent of total assets at December 31, 2002.

The decrease in gross and net loan volume during the reporting period is primarily attributed to participation volume decline due to forestry and land sales.

During 2003, the Association increased activity in the buying and selling of loan participations within and outside of the Farm Credit System (FCS). This provides a means for the Association to spread credit concentration risk and realize non-patronage sourced interest and fee income, which may strengthen its capital position. As of December 31, 2003, the Association had \$49,034 participation loans purchased from other FCS institutions, offset by \$52,223 in participation loans sold.

The Association sells qualified long-term mortgage loans into the secondary market. For the period ended December 31, 2003, the Association originated loans for resale totaling \$230, which was also the amount sold. The Association also participates in the Farmer Mac Long-Term Standby Commitment program. Farmer Mac was established by Congress to provide liquidity to agricultural lenders. At December 31, 2003, the Association had loans amounting to \$38,924, which were effectively guaranteed by Farmer Mac and \$18,624, which were guaranteed by FSA.

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

	<u>12/31/03</u>	<u>12/31/02</u>
High-risk Assets		
Nonaccrual loans	\$ 1,177	\$ 1,828
Restructured loans	—	10
Accruing loans 90 days past due	—	—
Total high-risk loans	<u>1,177</u>	<u>1,838</u>
Other property owned	—	—
Total high-risk assets	<u>\$ 1,177</u>	<u>\$ 1,838</u>
Ratios		
Nonaccrual loans to total loans	.51%	.76%
High-risk assets to total assets	.50%	.75%

Nonaccrual loans decreased \$651, or 35.61 percent in 2003. The decrease is primarily the result of the liquidation of a large nonaccrual account as well as increased efforts on all other nonaccruals. There are no significant potential credit risks within the loan portfolio that could adversely impact the performance of the loan portfolio in the near future.

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

There is an inherent risk in the extension of any type of credit. Association management analyzes credit quality, loan performance, concentration, and other forms of risk, maintaining an allowance for loan losses in an amount sufficient to absorb possible losses in the loan portfolio based on current and expected future conditions. The Association did not make any additions to the allowance for loan losses in 2003. Charge-offs for the period ended December 31, 2003 amounted to \$34, which was primarily attributed to a few row crop farming operations that have liquidated their assets. Offsetting the charge-offs for the period were recoveries totaling \$160, thus resulting in net recoveries of \$126. The ratio of net recoveries to average loans was 0.05 percent at December 31, 2003. The allowance for loan losses at December 31, 2003 was \$5,446, which was 2.37 percent of total loans outstanding and was considered by management to be adequate to cover possible losses. Please refer to Note 2 in the Notes to the Consolidated Financial Statements of this Annual Report for further information concerning the allowance for loan losses.

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

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

RESULTS OF OPERATIONS

Net income for the year ended December 31, 2003, totaled \$4,759, an increase of \$523 or 12.34 percent, as compared to \$4,236 for the same period of 2002. Interest income for the year ended December 31, 2003, was \$13,759, a decrease of \$1,530 or 10.01 percent as compared to \$15,289 for the same period of 2002. Interest expense also decreased by \$1,484 for the period ended December 31, 2003. Major components of the changes in net income for the past two years are outlined in the following table.

Changes in Net Income:

	2003-2002	2002-2001
Net income (prior year)	\$ 4,236	\$ 4,816
Increase (decrease) in net income due to:		
Interest income	(1,530)	(929)
Interest expense	1,484	895
Net interest income	(46)	(34)
Provision for loan losses	1,150	(1,000)
Noninterest income	515	604
Noninterest expense	(997)	(189)
Benefit (provision) for income taxes	(99)	39
Total changes in income	523	(580)
Net income	\$ 4,759	\$ 4,236

Net interest income decreased by \$46 or .70 percent in 2003 compared to 2002. The primary reason for this decrease was the result of the reduced interest rate environment during 2003. Net interest income, excluding interest income from nonaccrual loans, decreased \$1,369 as a result of interest rate spreads and decreased \$120 as a result in loan volume changes in 2003, compared to the same period of 2002. Interest income on nonaccrual loans for the twelve months ended December 31, 2003, totaled \$135, a decrease of \$41, compared to \$176 at the previous year-end. Please refer to the Consolidated Five-Year Summary of Selected Financial Data in this Annual Report to review key financial ratios pertaining to earnings and net interest income. The sources of change in net interest income are illustrated, as follows:

Change in Net Interest Income:

	Volume*	Rate	Nonaccrual	
			Income	Total
12/31/03 - 12/31/02				
Interest income	\$ (120)	\$ (1,369)	\$ (41)	\$ (1,530)
Interest expense	(119)	(1,365)	—	(1,484)
Change in net interest income	<u>\$ (1)</u>	<u>\$ (4)</u>	<u>\$ (41)</u>	<u>\$ (46)</u>
12/31/02 - 12/31/01				
Interest income	\$ 4,072	\$ (4,846)	\$ (155)	\$ (929)
Interest expense	2,850	(3,745)	—	(895)
Change in net interest income	<u>\$ 1,222</u>	<u>\$ (1,101)</u>	<u>\$ (155)</u>	<u>\$ (34)</u>

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

Noninterest income for the period ended December 31, 2003, increased \$515 as compared to the same period of 2002. The increase is primarily attributed to increases of loan fees by \$43, financially related services income by \$230, and patronage refunds from other Farm Credit institutions by \$267. The increases referenced were offset by a decrease in miscellaneous fees by \$25.

Noninterest expense increased \$997 or 22.36 percent for the twelve months ended December 31, 2003, as compared to the same period of 2002. Salaries and employee benefits accounted for \$729, or 73.12 percent of the increase in operating expenses due to normal salary and benefit increases. The association had incentive expenses in 2003. Also contributing to the increase of \$729 in salaries and benefit expenses was the \$503 in retirement fund expense recorded during the year 2003 as compared to \$311 in 2002. The retirement fund expense has increased over the last two years primarily as the result of the decline in market value of the invested plan assets. The amount of retirement expense and corresponding funding is determined by overall plan performance, which is measured as of September 30th of each year. Insurance Fund premiums also increased by \$200 for the period ended December 31, 2003 compared to the same period in 2002. Occupancy and equipment expenses along with other operating expenses increased \$6 and \$62, respectively, from the prior year-end.

The Association recorded a provision for income taxes of \$50 for the twelve months ended December 31, 2003, as compared to a benefit of \$49 for the same period in 2002.

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

LIQUIDITY AND FUNDING SOURCES

Liquidity

Liquidity management is the process whereby funds are made available to meet all financial commitments including the extension of credit, payment of operating expenses and payment of debt obligations. The Association receives access to funds through its borrowing relationship with AgFirst Farm Credit Bank (the Bank) and from income generated by operations. 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, 2003, were \$193,623 as compared to \$206,383 at December 31, 2002. The decrease of 6.18 percent during the period is attributable to the decrease in loan volume and in interest rates.

The Association had a \$2,000 line of credit outstanding with a third party as of December 31, 2003. No funds have been drawn against this line.

Funds Management

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

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

The Association's net interest income as a percentage of average earning assets (net interest margin) was 2.71 percent on December 31, 2003, which was also the same percent on December 31, 2002.

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

CAPITAL RESOURCES

Total members' equity at December 31, 2003, increased 2.42 percent to \$30,647 from the December 31, 2002, total of \$29,922. The increase is from net income partially offset by cash patronage, the revolvment of allocated retained earnings, and the reduction of capital stock and participation certificates.

Total capital stock and participation certificates were \$1,856 on December 31, 2003, compared to \$2,006 on December 31, 2002. This 7.48 percent decrease is attributed to the retirement of protected stock and participation certificates on loans liquidated in the normal course of business, retirement of excess stock through revolvment and new loans being capitalized at low regulatory rates. The Association's Consolidated Statement of Changes in Members' Equity reflects a comprehensive loss resulting from the underfunded status of the AgFirst Farm Credit District's defined benefit retirement plan for the years ended December 31, 2003 and December 31, 2002. See further discussion about this comprehensive loss in Note 9 to the Consolidated Financial Statements.

The Association's permanent capital ratio as of December 31, 2003 was 16.01 percent compared to 13.53 percent on December 31, 2002. Farm Credit Administration (FCA) regulations require all Farm Credit institutions maintain a minimum permanent capital ratio of 7 percent. The permanent capital ratio is calculated by dividing the Association's permanent capital by a risk-adjusted asset base.

FCA regulations also require all Farm Credit institutions to maintain two other minimum capital ratios: total surplus ratio of 7 percent and core surplus ratio of 3.5 percent. The total surplus and core surplus ratios are calculated by dividing total surplus and core surplus as defined in FCA regulations by a risk-adjusted asset base. As of December 31, 2003, the Association's total surplus ratio and core surplus ratio was 15.38 percent and 11.80 percent, respectively, as compared to 12.49 percent and 10.06 percent, respectively, on December 31, 2002.

Annually, the Association establishes target capital ratios. The Association's 2003 target permanent capital ratio was 13 to 15 percent of risk-adjusted assets. The targeted total surplus and core surplus ratios for 2003 were 12.00 percent and 9.00 percent, respectively. As of December 31, 2003, the Association exceeded all target capital ratios.

Disclosure Required by Farm Credit Administration Regulations

Description of Business

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

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

Description of Property

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

<u>Location</u>	<u>Description</u>	<u>Form of Ownership</u>
2229 South Irby Street Florence	Administrative/ Branch	Owned
207 East Liberty Street Sumter	Branch	Owned
212 Main Street Conway	Branch	Owned

Legal Proceedings

Information, if any, to be disclosed in this section is incorporated herein by reference to Note 12 to the consolidated financial statements, "Commitments and Contingencies," included in this annual report to stockholders.

Description of Capital Structure

Information to be disclosed in this section is incorporated herein by reference to Note 7 to the consolidated financial statements, "Members' Equity," included in this annual report to stockholders.

Description of Liabilities

The description of liabilities, contingent liabilities and intrasystem financial assistance rights and obligations to be disclosed in this section is incorporated herein by reference to Notes 2, 6, 10 and 12 to the consolidated financial statements included in this annual report to stockholders.

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

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

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

<u>Senior Officer</u>	<u>Position</u>
Jasper W. Shuler	President and Chief Executive Officer
Kathy S. Heustess	Chief Financial Officer
William H. Wise, Jr.	Chief Operating Officer
Richard H. Horn	Chief Credit Officer

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

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

<u>Aggregate Number of Senior Officers</u>	<u>Year</u>	<u>Annual</u>		<u>Total</u>
		<u>Salary</u>	<u>Bonus</u>	
CEO	2003	\$178,507	\$ 52,000	\$230,507
CEO	2001	\$160,120	\$ 30,000	\$190,120
7	2003	\$709,908	\$234,396	\$944,304
7	2002	\$668,024	—	\$668,024
7	2001	\$621,651	\$173,402	\$795,053

In addition to a base salary, all employees, with the exception of the chief executive officer, are eligible for additional compensation under incentive plans. In addition to the general plan, specified employees are eligible for individual or group incentive plans. The chief executive officer is eligible for a bonus at the sole discretion of the board.

Executive management, excluding the chief executive officer, is eligible for an incentive plan based on overall company results. The general incentive plan is designed to reward excellent performance while increasing the Association's financial position and stockholder wealth. The individual and group incentive plans are specifically for account officers, credit officers, participations credit support/accounting staff, special asset manager, and farm-related business coordinator to reward them when goals in their incentive plans are exceeded.

The goals of the account officers' plan include generation of fee and farm related services income in excess of salaries with an on/off switch based on Association delinquencies. The goal of the credit officer plan is to generate fee income from loans in excess of salary with on/off switches based on credit administration, credit quality and net interest margin. The goal of the participations plan is to generate fee income in excess of salaries with on/off switches based on credit quality and credit administration. The goal of the special asset manager's plan is to resolve and collect nonaccrual loans with an on/off switch based on Association delinquencies. The goal of the farm related services coordinator's plan is to increase related services income over previous year's income. The general plan is paid based on a percentage of net income in excess of budgeted net income. The key factors for payment of the general plan include return on assets, credit quality, permanent capital, CIPA rating and customer satisfaction survey results. The criteria for payment of all incentive plans include: employees must be employed as of the fiscal year end, new employees with less than a full year of employment will receive a pro rata share based on the number of full months employed during the calendar year, employees who retire or die prior to year end will receive a pro rata share of the incentive, the plan will be paid based on percentage of salary, and will be paid from the Association's core earnings. The employees must have satisfactory performance and not have been on probation during the year. The payment of the incentive available to all employees is determined on a percentage basis. The executive plan has four categories that are equally weighted and payment is made on a per category basis. If all four categories are met, executive management is additionally eligible for 5 percent of net income in excess of budgeted income. No material changes were made to existing plans from previous year. Bonuses are shown in the year earned, which may be different than the year of payment.

Disclosure of the total compensation earned in 2003 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 \$34,123 for 2003, \$27,993 for 2002, and \$18,609 for 2001.

Subject to approval by the board, the Association allows directors monthly honoraria of \$375 and a per diem of the same amount for attendance at committee meetings or special assignments. Total compensation paid to directors, as a group was \$55,125.

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

Dale W. Player, Chairman, is a farmer and serves on the boards of AgFirst Farm Credit Bank, SC Cotton Board, and Carolina Cotton Growers Cooperative. He has been a self-employed farmer for the past five years. During 2003, he served 8 days at Association board meetings and 15 days in other official activities and was paid \$7,500. His three-year term of office began March 2001.

Harry B. DuRant, Vice Chairman, is a farmer and serves on the Laurence Manning Academy school board and the Phillip Morris Quality Advisory Committee. He has been a self-employed farmer for the past five years. During 2003, he served 8 days at Association board meetings and 12 days in other official activities and was paid \$9,000. His three-year term of office began March 2003.

DuPree Atkinson is a farmer and serves on SC Tobacco Board, the Clemson Advisory Committee, the Mullins Chamber of Commerce, and both the Marion County and SC Farm Bureau boards. He has been a self-employed farmer for the past five years. During 2003, he served 8 days at Association board meetings and 3 days in other official activities and was paid \$5,625. His three-year term of office began March 2002.

W. Edwin Dargan, Jr. is a farmer and serves on the boards of SC Soybean Association, Darlington County Bank, and Darlington County Farm Service Agency. He has been a self-employed farmer for the past five years. During 2003, he served 8 days at Association board meetings and 7 days in other official activities and was paid \$7,125. His three-year term of office began March 2003.

Dr. Timothy W. Koch is a professor of finance and has been with the Moore School of Business at the University of South Carolina for the past five years. During 2003, he served 3 days at Association board meetings and 2 days in other official activities and was paid \$3,375. His three-year term of office began April 2003.

Jimmy Poston is a farmer and serves on the boards of Florence County Soil and Water Conservation District, Quality Assurance Committee for Phillip Morris, SC Tobacco Grower's Association and the Southern States Advisory Board. He has been a self-employed farmer for the past five years. During 2003, he served 7 days at Association board meetings and 5 days in other official activities and was paid \$6,000. His three-year term of office began March 2003.

Harold C. Stowe is President of Canal Holding, LLC and serves on the boards of New South Companies, Ruddick Corporation, and SCANA Corporation. He has been in Executive Management at Canal Holdings, LLC for the past five years. During 2003, he served 5 days at Association board meetings and 2 days in other official activities and was paid \$4,125. His three-year term of office began April 2003.

James M. Ward is a farmer and serves on the boards of Farm Service Agency Florence County Committee, Farm Service Agency Tobacco Appeals Committee, and Southern States Advisory Board. He has been a self-employed farmer for the past five years. During 2003, he served 12 days at Association board meetings and 9 days in other official activities and was paid \$7,875. His three-year term of office began March 2001.

Transactions with Senior Officers and Directors

The reporting entity's policies on loans to and transactions with its officers and directors, to be disclosed in this section are incorporated herein by reference to Note 11 to the consolidated financial statements, "Related Party Transactions," included in this annual report to stockholders.

Involvement in Certain Legal Proceedings

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

Relationship with Independent Public Accountants

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

Consolidated Financial Statements

The consolidated financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated February 19, 2004, 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 1-800-741-7332, or writing Kathy S. Heustess, Chief Financial Officer, Pee Dee Farm Credit, P. O. Box 13209, Florence, SC 29504.

Borrower Information Regulations

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

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

Stockholder Investment

Stockholder investment in the Association could be affected by the financial condition and results of operations of AgFirst Farm Credit Bank. Copies of the District annual and quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 503, or writing Patti Trotter, AgFirst Farm Credit Bank, P. O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained by going to AgFirst's website at www.agfirst.com.

Report of Independent Auditors



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

Report of Independent Auditors

February 19, 2004

To the Board of Directors and Stockholders
of Pee Dee Farm Credit, ACA

We have audited the accompanying consolidated balance sheets of Pee Dee Farm Credit, ACA (Association) and its subsidiaries as of December 31, 2003, 2002, and 2001, and the related consolidated statements of income, of changes in members' equity, and of cash flows for each of the three years in the period ended December 31, 2003. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

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

PricewaterhouseCoopers LLP

Consolidated Balance Sheets

<i>(dollars in thousands)</i>	December 31, 2003	December 31, 2002	December 31, 2001
Assets			
Cash	\$ 2	\$ 2	\$ 3
Loans	230,091	240,891	223,041
Less: allowance for loan losses	5,446	5,320	5,459
Net loans	224,645	235,571	217,582
Accrued interest receivable	2,305	2,620	2,812
Investment in other Farm Credit institutions	3,774	4,212	4,216
Premises and equipment, net	674	618	655
Other assets	2,299	2,299	2,646
Total assets	\$ 233,699	\$ 245,322	\$ 227,914
Liabilities			
Notes payable to AgFirst Farm Credit Bank	\$ 193,623	\$ 206,383	\$ 190,993
Accrued interest payable	555	679	705
Patronage refund payable	2,168	1,641	1,913
Minimum pension liability	1,380	1,467	—
Other liabilities	5,326	5,230	2,420
Total liabilities	203,052	215,400	196,031
Commitments and contingencies			
Members' Equity			
Protected borrower equity	701	818	1,053
Capital stock and participation certificates	1,155	1,188	1,194
Retained earnings			
Allocated	16,653	15,735	15,124
Unallocated	14,618	14,865	14,512
Accumulated other comprehensive income (loss)	(2,480)	(2,684)	—
Total members' equity	30,647	29,922	31,883
Total liabilities and members' equity	\$ 233,699	\$ 245,322	\$ 227,914

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

Consolidated Statements of Income

<i>(dollars in thousands)</i>	For the year ended December 31,		
	2003	2002	2001
Interest Income			
Loans	\$ 13,759	\$ 15,289	\$ 16,218
Interest Expense			
Notes payable to AgFirst Farm Credit Bank	7,289	8,773	9,668
Net interest income	6,470	6,516	6,550
Provision for (reversal of) loan losses	—	1,150	150
Net interest income after provision for (reversal of) loan losses	6,470	5,366	6,400
Noninterest Income			
Loan fees	745	702	854
Fees for financially related services	469	239	250
Patronage refund from other Farm Credit institutions	2,318	2,051	1,307
Other noninterest income	261	286	263
Total noninterest income	3,793	3,278	2,674
Noninterest Expense			
Salaries and employee benefits	3,849	3,120	3,128
Occupancy and equipment	289	283	291
Insurance Fund premium	272	72	—
Other operating expenses	1,044	982	849
Total noninterest expense	5,454	4,457	4,268
Income before income taxes	4,809	4,187	4,806
Provision (benefit) for income taxes	50	(49)	(10)
Net income	\$ 4,759	\$ 4,236	\$ 4,816

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

Consolidated Statements of Changes in Members' Equity

<i>(dollars in thousands)</i>	Protected Borrower Equity	Capital Stock and Participation Certificates	Retained Earnings		Accumulated Other Comprehensive Income	Total Members' Equity
			Allocated	Unallocated		
Balance at December 31, 2000	\$ 1,194	\$ 1,152	\$ 14,577	\$ 14,447	\$ —	\$ 31,370
Net income				4,816		4,816
Protected borrower equity retired	(141)					(141)
Capital stock/participation certificates issued		132				132
Capital stock/participation certificates retired		(90)				(90)
Patronage distribution						
Cash				(1,868)		(1,868)
Qualified allocated retained earnings			2,802	(2,802)		—
Retained earnings retired			(2,306)			(2,306)
Distribution adjustment			51	(81)		(30)
Balance at December 31, 2001	1,053	1,194	15,124	14,512	—	31,883
Comprehensive income						
Net income				4,236		4,236
Minimum pension liability adjustment					(2,684)	(2,684)
Total comprehensive income						1,552
Protected borrower equity retired	(235)					(235)
Capital stock/participation certificates issued		88				88
Capital stock/participation certificates retired		(94)				(94)
Patronage distribution						
Cash				(1,590)		(1,590)
Qualified allocated retained earnings			1,741	(1,741)		—
Nonqualified allocated retained earnings			643	(643)		—
Retained earnings retired			(1,716)			(1,716)
Distribution adjustment			(57)	91		34
Balance at December 31, 2002	818	1,188	15,735	14,865	(2,684)	29,922
Comprehensive income						
Net income				4,759		4,759
Minimum pension liability adjustment					204	204
Total comprehensive income						4,963
Protected borrower equity retired	(117)					(117)
Capital stock/participation certificates issued		83				83
Capital stock/participation certificates retired		(116)				(116)
Patronage distribution						
Cash				(1,997)		(1,997)
Qualified allocated retained earnings			2,075	(2,075)		—
Nonqualified allocated retained earnings			921	(921)		—
Retained earnings retired			(2,086)			(2,086)
Distribution adjustment			8	(13)		(5)
Balance at December 31, 2003	\$ 701	\$ 1,155	\$ 16,653	\$ 14,618	\$ (2,480)	\$ 30,647

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

Consolidated Statements of Cash Flows

<i>(dollars in thousands)</i>	For the year ended December 31,		
	2003	2002	2001
Cash flows from operating activities:			
Net income	\$ 4,759	\$ 4,236	\$ 4,816
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation on premises and equipment	176	151	166
Provision for (reversal of) loan losses	—	1,150	150
(Gains) losses from sale of premises and equipment, net	—	(14)	—
Changes in operating assets and liabilities:			
(Increase) decrease in accrued interest receivable	315	192	291
(Increase) decrease in other assets	—	347	(417)
Increase (decrease) in accrued interest payable	(124)	(26)	(21)
Increase (decrease) in minimum pension liability	(87)	1,467	—
Increase (decrease) in other liabilities	300	126	(205)
Total adjustments	580	3,393	(36)
Net cash provided by (used in) operating activities	5,339	7,629	4,780
Cash flows from investing activities:			
Net (increase) decrease in loans	10,926	(19,139)	(70,911)
(Increase) decrease in investment in other Farm Credit institutions	438	4	(7)
Purchase of premises and equipment, net	(232)	(114)	(137)
Proceeds from sale of premises and equipment, net	—	14	—
Net cash provided by (used in) investing activities	11,132	(19,235)	(71,055)
Cash flows from financing activities:			
Advances on (repayment of) notes payable to AgFirst Farm Credit Bank, net	(12,760)	15,390	70,523
Protected borrower equity retired	(117)	(235)	(141)
Capital stock and participation certificates issued	83	88	132
Capital stock and participation certificates retired	(116)	(94)	(90)
Patronage refunds paid	(1,475)	(1,828)	(1,843)
Retained earnings retired	(2,086)	(1,716)	(2,306)
Net cash provided by (used in) financing activities	(16,471)	11,605	66,275
Net increase (decrease) in cash	—	(1)	—
Cash, beginning of period	2	3	3
Cash, end of period	\$ 2	\$ 2	\$ 3
Supplemental schedule of non-cash investing and financing activities:			
Cash dividends or patronage distributions declared or payable	\$ 1,997	\$ 1,590	\$ 1,868
Supplemental information:			
Interest paid	\$ 7,413	\$ 8,799	\$ 9,689
Taxes paid, net	8	59	24

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:** Pee Dee Farm Credit, ACA (the Association) is a member-owned cooperative which provides credit and credit-related services to or for the benefit of eligible borrowers/stockholders for qualified purposes in the counties of Abbeville, Allendale, Calhoun, Charleston, Chesterfield, Clarendon, Darlington, Dillon, Florence, Georgetown, Greenville, Greenwood, Horry, Jasper, Kershaw, Lancaster, Lee, Lexington, Marion, Marlboro, Richland, Saluda, Sumter and Williamsburg in the state of South Carolina; the counties of Alachua, Charlotte, Collier, Columbia, DeSoto, Duval, Hendry, Hernando, Highlands, Nassau, Palm Beach and Polk in the state of Florida; the counties of Baldwin, Decatur and Evans in the state of Georgia; the counties of Anson, Brunswick, Columbus, Cumberland, Mecklenburg, Robeson and Union in the state of North Carolina; Allen County in the state of Kansas; Wicomico County in the state of Maryland; Genesee County in the state of New York; Shelby County in the state of Tennessee; Harris and Houston Counties in the state of Texas; and Isle of Wright County in the state of Virginia, in cooperation with the ACAs chartered in those territories.

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, 2003, the System was comprised of four Farm Credit Banks and one Agricultural Credit Bank and numerous Associations.

Effective January 1, 2002, pursuant to a plan of restructuring approved by the Farm Credit Administration (FCA) and Association shareholders, the Association reorganized its existing organizational structure. Pursuant to this restructuring, an FLCA and a PCA were formed as wholly owned subsidiaries of the Association. The formation of these subsidiaries enables the Association to take advantage of the tax-exempt status of net income from long-term mortgage operations of the FLCA. This restructuring was accounted for as a reorganization of entities under common control similar to a pooling of interests.

Prior to the restructuring, the ACA was subject to federal and state income tax. As a result of the restructuring, long-term lending activity was separated into a wholly owned

FLCA subsidiary, which is exempt from federal and state income tax. The ACA, which is the holding company, along with the wholly owned PCA subsidiary, continue to be subject to income tax.

AgFirst Farm Credit Bank (Bank) and its related Associations are collectively referred to as the "District." The Bank 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-four ACAs, twenty-two of which have reorganized as ACA parent-companies, which have two wholly owned subsidiaries, an FLCA and a PCA.

ACA parent-companies provide financing and related services through its FLCA and ACA. The PCA is dormant. The FLCA makes secured long-term agricultural real estate and rural home mortgage loans. The ACA 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 to (1) ensure the timely payment of principal and interest on Systemwide debt obligations (Insured debt), (2) ensure the retirement of protected borrower capital at par or stated value, and (3) for other specified purposes. The Insurance Fund is also available for discretionary uses by the Insurance Corporation of providing assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation. Each System bank is required to pay premiums into the Insurance Fund, based on its annual average loan principal outstanding until the monies in the Insurance Fund reach the "secure base amount," which is defined in the Farm Credit Act as 2.0 percent of the aggregate insured obligations (Systemwide debt obligations). When the amount in the Insurance Fund exceeds the secure base amount, the Insurance Corporation is required to reduce premiums, but it still must ensure that reduced premiums are sufficient to maintain the level of the Insurance Fund at the secure base amount.

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

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

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

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

Note 2 — Summary of Significant Accounting Policies

The accounting and reporting policies of the Association conform with accounting principles generally accepted in the United States 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 either reversed (if accrued in the current year) or charged against the allowance for loan losses (if accrued in prior years).

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

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

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

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

- C. Investment in AgFirst Farm Credit Bank:** The Association is required to maintain ownership in the Bank in the form of Class B and Class C stock. Accounting for this investment is on the cost plus allocated equities basis. Patronage refunds from the Bank are accrued as earned. The receivable for such patronage refunds is included in other assets.
- D. Other Property Owned:** Other property owned, consisting of real and personal property acquired through a collection action, is recorded at fair value less estimated selling costs upon acquisition. Revised estimates to the fair value less cost to sell are reported as adjustments to the carrying amount of the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Income and expenses from operations and carrying value adjustments are included in gains (losses) on other property owned.
- E. Premises and Equipment:** Premises and equipment are carried at cost less accumulated depreciation. Depreciation is provided on the straight-line method over the estimated useful lives of the assets. Gains and losses on dispositions are reflected in current operations. Maintenance and repairs are charged to operating expense and improvements are capitalized.
- F. Advanced Conditional Payments:** The Association is authorized under the Farm Credit Act to accept advance payments from borrowers. To the extent the borrower's access to such advance payments is restricted, the advanced conditional payments are netted against the borrower's related loan balance. Advanced conditional payments are not insured. Interest is generally paid by the Association on such accounts.
- G. Employee Benefit Plans:** The employees of the Association participate in the 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 the "Entry Age Normal Cost" actuarial method for funding purposes. As a result of the funded status at the Plan's measurement date (September 30) of the underlying Plan, the Association may record a minimum liability, an intangible asset relating to unrecognized prior service cost and other comprehensive income (loss). The adjustment to other comprehensive income (loss) would be net of deferred taxes, if significant. 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 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 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 normal retirement age while working for the Association. Expenses of \$567, \$428 and \$344 for the years ended December 31, 2003, 2002 and 2001, respectively, were classified as salaries and employee benefits.

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

Effective January 1, 2002, the Association formed a tax exempt subsidiary as described in Note 1.

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

Note 3 — Loans and Allowance for Loan Losses

A summary of loans follows:

	December 31,		
	2003	2002	2001
Long-term farm mortgage	\$ 63,795	\$ 60,396	\$ 45,947
Production and intermediate-term	110,084	125,671	120,344
Rural home	10,727	11,361	11,561
Farm related business	6,567	7,971	5,863
Processing and marketing	35,832	36,811	1,855
Sales contracts/investments	5,098	352	472
Nonaccruals	1,177	1,828	514
Plus: participations purchased	49,034	55,333	60,088
Less: participations sold	(52,223)	(58,832)	(23,603)
Total	\$ 230,091	\$ 240,891	\$ 223,041

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, 2003, 2002 and 2001 consisted of the following commodity types:

Commodity Type	December 31,		
	2003	2002	2001
Forestry	23%	21%	17%
Poultry	17	16	19
Row Crops	17	9	11
Livestock	16	6	8
Tobacco	9	11	12
Field/Grain	4	4	10
Rural Home	4	4	5
Nurseries	3	3	3
Cotton Gins	2	2	1
Other	5	24	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% (97% 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,		
	2003	2002	2001
Nonaccrual loans:			
Current as to principal and interest	\$ 235	\$ 832	\$ 300
Past due	942	996	214
Total nonaccrual loans	1,177	1,828	514
Impaired accrual loans:			
Restructured accrual loans	—	10	27
Accrual loans 90 days or more past due	—	—	—
Total impaired accrual loans	—	10	27
Total impaired loans	\$ 1,177	\$ 1,838	\$ 541

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

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,		
	2003	2002	2001
Interest income recognized on nonaccrual loans	\$ 135	\$ 176	\$ 331
Interest income on impaired accrual loans	3	1	3
Interest income recognized on impaired loans	\$ 138	\$ 177	\$ 334

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

	2003	2002	2001
Impaired loans with related allowance	\$ 739	\$ 46	\$ 1
Impaired loans with no related allowance	438	1,792	540
Total impaired loans	\$ 1,177	\$ 1,838	\$ 541

Allowance on impaired loans	\$ 2	\$ 5	\$ 1
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The following table summarizes impaired loan information for the year ended December 31,

	2003	2002	2001
Average impaired loans	\$ 1,905	\$ 1,647	\$ 739

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

	Year Ended December 31,		
	2003	2002	2001
Balance at beginning of year	\$ 5,320	\$ 5,459	\$ 5,447
Provision for (reversal of) loan losses	—	1,150	150
Loans charged off	(34)	(1,291)	(209)
Recoveries	160	2	71
Balance at end of year	\$ 5,446	\$ 5,320	\$ 5,459
Ratio of net charge-offs during the period to average loans outstanding during the period	(.05)%	.53%	.07%

To mitigate the risk of loans being placed in nonaccrual status, 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 a delinquency of four months occurs. Pee Dee Farm Credit has Farm Service and USDA guarantees of \$18,624, \$16,652 and \$12,932 as of December 31, 2003, 2002 and 2001, respectively. Further, Pee Dee Farm Credit has Farmer Mac long-term standby commitments of \$38,924, \$22,396 and \$15,287 at December 31, 2003, 2002 and 2001, respectively. Fees paid to

Farmer Mac for such commitments totaled \$116, \$104 and \$23 for the years ended December 31, 2003, 2002 and 2001, respectively. These amounts are classified as noninterest expense.

Note 4 — Investment in AgFirst Farm Credit Bank

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

Note 5 — Premises and Equipment

Premises and equipment consisted of the following:

	December 31,		
	2003	2002	2001
Land	\$ 110	\$ 110	\$ 110
Buildings and improvements	827	828	828
Furniture and equipment	753	819	792
	<u>1,690</u>	<u>1,757</u>	<u>1,730</u>
Less: accumulated depreciation	<u>1,016</u>	<u>1,139</u>	<u>1,075</u>
Total	<u>\$ 674</u>	<u>\$ 618</u>	<u>\$ 655</u>

Note 6 — Notes Payable to AgFirst Farm Credit Bank

The Association's indebtedness to the Bank represents borrowings by the Association to fund its loan portfolio. This indebtedness is collateralized by a pledge of substantially all of the Association's assets and the terms of the revolving lines of credit are governed by a general financing agreement. Interest rates on both variable and fixed rate notes payable are generally established loan-by-loan based on the Bank's marginal cost of funds, capital position, operating costs and return objectives. The interest rate is periodically adjusted by the Bank based upon agreement between the Bank and Association. The weighted average interest rates on the variable rate notes were 2.32 percent for LIBOR-based loans, 2.22 percent for Prime-based loans, and the weighted average remaining maturities were 4.3 years and 6.1 years, respectively, at December 31, 2003. The weighted average interest rate on the fixed rate and adjustable rate mortgage (ARM) notes payable which are match funded by the Bank was 4.38 percent and the weighted average remaining maturity was 6.0 years at December 31, 2003. The weighted average interest rate on all interest-bearing notes payable was 3.21 percent and the weighted average remaining maturity was 5.4 years at December 31, 2003.

Variable rate and fixed rate notes payable represent approximately 47.23 percent and 52.77 percent, respectively, of total notes payable at December 31, 2003.

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, 2003, the Association's notes payable were within the specified limitations.

Note 7 — Members' Equity

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

A. Protected Borrower Equity

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

B. Capital Stock and Participation Certificates

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

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

C. Regulatory Capitalization Requirements and Restrictions

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

These required ratios are total surplus as a percentage of risk-adjusted assets of seven percent and of core surplus as a percentage of risk-adjusted assets of three and one-half percent. The Association's permanent capital, total surplus and core surplus ratios at December 31, 2003 were 16.01 percent, 15.38 percent and 11.80 percent, respectively.

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

D. Description of Equities

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

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

Class	Shares Outstanding		
	Protected	Number	Aggregate Par Value
A Common/Nonvoting	Yes	38,686	\$ 193
B Common/Nonvoting	Yes	88,502	443
C Common/Voting	No	209,428	1,047
B Participation Certificates/Nonvoting	Yes	13,061	65
C Participation Certificates/Nonvoting	No	21,563	108
Total Capital Stock and Participation Certificates		371,240	\$ 1,856

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

Retained Earnings

The Association maintains an unallocated retained earnings account and an allocated retained earnings account. The 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. All nonqualified distributions are tax deductible only when redeemed.

At December 31, 2003, allocated members' equity consisted of \$15,119 of qualified surplus, \$1,534 of nonqualified allocated 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.

Dividends

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

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

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

Transfer

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

Impairment

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

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

Liquidation

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

1. Holders of Classes A and D Preferred Stock
2. Holders of Classes A and B Common Stock and Class B Participation Certificates
3. Holders of Class C Common Stock and Class C Participation Certificates
4. Holders of allocated surplus evidenced by qualified written notices of allocation, in the order of year of issuance and pro rata by year of issuance, until the total amount of such allocated surplus has been distributed
5. Holders of allocated surplus evidenced by nonqualified written notices of allocation, in the order of year of issuance and pro rata by year of issuance, until the total amount of such allocated surplus has been distributed
6. Any remaining assets of the Association after such distributions shall be distributed to past and present Patrons on a patronage basis, to the extent practicable

E. 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. See Note 9 for further information.

Note 8 — Income Taxes

The provision (benefit) for income taxes follows:

	Year Ended December 31,		
	2003	2002	2001
Current:			
Federal	\$ 25	\$ (12)	\$ 87
State	5	(2)	12
Federal refunds related to long-term lending	—	—	(139)
	<u>30</u>	<u>(14)</u>	<u>(40)</u>
Deferred:			
Federal	21	(35)	27
State	(1)	—	3
	<u>20</u>	<u>(35)</u>	<u>30</u>
Total provision (benefit) for income taxes	<u>\$ 50</u>	<u>\$ (49)</u>	<u>\$ (10)</u>

In connection with the restructuring discussed in Note 1, the net deferred tax asset relating to the long-term lending activities was written off as of January 1, 2002 to reflect the change in tax status. The amount of this write-off was not significant. During 2001, the Association signed a settlement agreement with the IRS resolving the taxability of the prior years' earnings from its long-term mortgage lending activities. This settlement agreement was modeled after one used by another System ACA to reach a settlement agreement with the IRS in August 2000. As a result of this settlement, the Association recorded a tax refund of \$139, which was included as a component of the 2001 current income tax provision. In addition, the Association recorded \$70 in interest related to these refunds, which was included in Other Income in the accompanying Statements of Income. All such refunds have been received by the Association.

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,		
	2003	2002	2001
Federal tax at statutory rate	\$ 1,635	\$ 1,424	\$ 1,634
State tax, net	2	—	10
Patronage distributions	(1,013)	(1,057)	(1,588)
Tax-exempt FLCA earnings	(594)	(361)	—
Long-term lending related refunds	—	—	(139)
Deferred tax asset adjustment	—	(7)	—
Other	20	(48)	73
Provision (benefit) for income taxes	<u>\$ 50</u>	<u>\$ (49)</u>	<u>\$ (10)</u>

Deferred tax assets and liabilities result from the following at:

	December 31,		
	2003	2002	2001
Annual leave	\$ 4	\$ 6	\$ (6)
Postretirement benefits other than pensions	14	—	19
Depreciation (reclassified)	1	—	1
Gross deferred tax assets	<u>19</u>	<u>6</u>	<u>14</u>
Future Bank equity redemption	(29)	(4)	(30)
Pensions	(9)	(1)	(18)
Gross deferred tax liability	<u>(38)</u>	<u>(5)</u>	<u>(48)</u>
Net deferred tax asset (liability)	<u>\$ (19)</u>	<u>\$ 1</u>	<u>\$ (34)</u>

At December 31, 2003, deferred income taxes have not been provided by the Association on approximately \$0.5 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 9 — Employee Benefit Plans

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

At December 31, 2003 and 2002, the Accumulated Benefit Obligation (ABO) of the District’s defined benefit plan exceeded the fair value of plan assets. In accordance with the provisions of SFAS No. 87, “Employers’ Accounting for Pensions,” (SFAS No. 87), the 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, other comprehensive loss was \$2,480 and \$2,684 for the years ended December 31, 2003 and 2002, respectively. The impact on deferred taxes was not significant.

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 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. Subsidies under the Medicare Act will reduce the current period measurements of benefits expected to be provided in future periods. These financial statements and disclosures do not reflect the effects of the Act. Specific authoritative guidance on the accounting for the federal subsidy is pending and that guidance, when issued, could require changes to previously reported information.

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

	2003	2002	2001
Pension	\$ 503	\$ 311	\$ 2
Thrift/deferred compensation	64	54	66
Other postretirement benefits	<u>567</u>	<u>428</u>	<u>344</u>
Total	<u>\$ 1,134</u>	<u>\$ 793</u>	<u>\$ 412</u>

Note 10 — Intra-System Financial Assistance

The Farm Credit System Financial Assistance Corporation (Financial Assistance Corporation) was established in 1988 primarily to provide capital to institutions of the System experiencing financial difficulty. Such assistance was funded through the Financial Assistance Corporation’s issuance of \$1.261 billion of 15-year U.S. Treasury-guaranteed debt. The interest rates on these issuances range from 8.80 percent to 9.45 percent. The repayment of this debt and related interest is the responsibility of System banks. At December 31, 2003, only \$325 million of Financial Assistance Corporation debt remains outstanding. 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, 2003, the assets in the Insurance Fund aggregated \$2.033 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 11 — Related Party Transactions

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

Total loans to such persons at December 31, 2003 amounted to \$36,136. During 2003, \$109,763 of new loans were made and repayments totaled \$113,005. In the opinion of management, none of these loans outstanding at December 31, 2003 involved more than a normal risk of collectibility.

Note 12 — 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 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, 2003, \$54,915 of commitments to extend credit and \$6,021 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 March 18, 2004 to August 6, 2008.

Note 13 — 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, 2003, 2002 and 2001. The fair value of a financial instrument is generally defined as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

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

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

	<u>December 31, 2003</u>		<u>December 31, 2002</u>	
	<u>Carrying Amount</u>	<u>Estimated Fair Value</u>	<u>Carrying Amount</u>	<u>Estimated Fair Value</u>
Financial assets:				
Cash	\$ 2	\$ 2	\$ 2	\$ 2
Loans	\$ 230,091	\$ 232,757	\$ 240,891	\$ 245,814
Allowance for loan losses	5,446	—	5,320	—
Loans, net	<u>\$ 224,645</u>	<u>\$ 232,757</u>	<u>\$ 235,571</u>	<u>\$ 245,814</u>
Financial liabilities:				
Notes payable to AgFirst Farm Credit Bank	\$ 193,623	\$ 193,793	\$ 206,383	\$ 208,418
	<u>December 31, 2001</u>			
	<u>Carrying Amount</u>	<u>Estimated Fair Value</u>		
Financial assets:				
Cash	\$ 3	\$ 3		
Loans	\$ 223,041	\$ 223,747		
Allowance for loan losses	5,459	—		
Loans, net	<u>\$ 217,582</u>	<u>\$ 223,747</u>		
Financial liabilities:				
Notes payable to AgFirst Farm Credit Bank	\$ 190,993	\$ 191,188		

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

- A. **Cash:** The carrying value is a reasonable estimate of fair value.
- B. **Loans:** Because no active market exists for the Association's loans, fair value is estimated by discounting the expected future cash flows using the Association's current interest rates at which similar loans would be made to borrowers with similar credit risk. As the discount rates are based on the Bank's loan rates, as well as management

estimates, management has no basis to determine whether the fair values presented would be indicative of the value negotiated in an actual sale.

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

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

The carrying value of accrued interest approximates its fair value.

C. Investment in AgFirst Farm Credit Bank and Other Farm Credit Institutions: Estimating the fair value of the Association's investment in the Bank is not practicable because the stock is not traded. As described in Note 4, the net investment is a requirement of borrowing from the Bank and is carried at cost plus allocated equities in the accompanying balance sheet. The Association owns 1.94 percent of the issued stock of the Bank as of December 31, 2003 net of any reciprocal investment. As of that date, the Bank's assets totaled \$15.9 billion and shareholders' equity totaled \$955 million. The Bank's earnings were \$177 million during 2003.

In addition, the Association has an investment of \$480 related to other Farm Credit institutions.

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

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

Note 14 — Quarterly Financial Information (Unaudited)

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

	2003				
	First	Second	Third	Fourth	Total
Net interest income	\$ 1,632	\$ 1,642	\$ 1,683	\$ 1,513	\$ 6,470
Provision for (reversal of) loan losses	—	—	—	—	—
Noninterest income (expense), net	(299)	(455)	(481)	(476)	(1,711)
Net income (loss)	\$ 1,333	\$ 1,187	\$ 1,202	\$ 1,037	\$ 4,759

	2002				
	First	Second	Third	Fourth	Total
Net interest income	\$ 1,561	\$ 1,646	\$ 1,716	\$ 1,593	\$ 6,516
Provision for (reversal of) loan losses	—	250	750	150	1,150
Noninterest income (expense), net	(298)	(433)	(425)	26	(1,130)
Net income (loss)	\$ 1,263	\$ 963	\$ 541	\$ 1,469	\$ 4,236

	2001				
	First	Second	Third	Fourth	Total
Net interest income	\$ 1,610	\$ 1,691	\$ 1,692	\$ 1,557	\$ 6,550
Provision for (reversal of) loan losses	—	—	—	150	150
Noninterest income (expense), net	(398)	(427)	(554)	(205)	(1,584)
Net income (loss)	\$ 1,212	\$ 1,264	\$ 1,138	\$ 1,202	\$ 4,816