

2008

ANNUAL REPORT

***FARM CREDIT
OF WESTERN OKLAHOMA, ACA***

Five-Year Summary of Selected Consolidated Financial Data

(Dollars in Thousands)

| | December 31 | | | | |
|---------------------------------------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
| | 2008 | 2007 | 2006 | 2005 | 2004 |
| Statement of Condition Data | | | | | |
| Loans | \$ 322,796 | \$ 254,541 | \$ 215,364 | \$ 209,001 | \$ 203,644 |
| Less allowance for loan losses | 2,069 | 1,523 | 1,620 | 1,621 | 2,015 |
| Net loans | 320,727 | 253,018 | 213,744 | 207,380 | 201,629 |
| Investment in dealer notes | - | - | - | - | 612 |
| Investment in U.S. AgBank, FCB | 7,805 | 7,410 | 7,410 | 7,073 | 6,826 |
| Other assets | 13,081 | 12,154 | 11,911 | 8,955 | 8,363 |
| Total assets | \$ 341,613 | \$ 272,582 | \$ 233,065 | \$ 223,408 | \$ 217,430 |
| Obligations with maturities of one year or less | \$ 5,751 | \$ 5,805 | \$ 5,282 | \$ 3,915 | \$ 3,536 |
| Obligations with maturities longer than one year | 269,788 | 204,094 | 167,090 | 160,725 | 157,051 |
| Total liabilities | 275,539 | 209,899 | 172,372 | 164,640 | 160,587 |
| Protected borrower stock | 10 | 29 | 37 | 55 | 93 |
| Capital stock | 1,265 | 1,286 | 1,282 | 1,315 | 1,428 |
| Unallocated retained earnings | 64,799 | 61,368 | 59,374 | 57,398 | 55,322 |
| Total shareholders' equity | 66,074 | 62,683 | 60,693 | 58,768 | 56,843 |
| Total liabilities and shareholders' equity | \$ 341,613 | \$ 272,582 | \$ 233,065 | \$ 223,408 | \$ 217,430 |

| | For the Year Ended December 31 | | | | |
|----------------------------------------------|--------------------------------|-----------------|-----------------|-----------------|-----------------|
| | 2008 | 2007 | 2006 | 2005 | 2004 |
| Statement of Income Data | | | | | |
| Net interest income | \$ 8,607 | \$ 6,935 | \$ 6,952 | \$ 6,365 | \$ 6,753 |
| Patronage distribution from U.S. AgBank, FCB | 1,268 | 1,481 | 1,440 | 1,244 | 845 |
| Loan loss reversal | (1,071) | (162) | (29) | (177) | (2,028) |
| Noninterest expense, net | 5,494 | 4,572 | 4,506 | 4,114 | 3,854 |
| Provision for/(Benefit from) income taxes | 21 | 13 | (18) | 99 | 1 |
| Net income | \$ 5,431 | \$ 3,993 | \$ 3,933 | \$ 3,573 | \$ 5,771 |

Key Financial Ratios

For the Year

| | | | | | |
|------------------------------------------------------------------------------------|---------|---------|---------|-------|--------|
| Return on average assets | 1.81% | 1.59% | 1.72% | 1.62% | 2.62% |
| Return on average shareholders' equity | 8.18% | 6.34% | 6.58% | 6.18% | 10.53% |
| Net interest income as a percentage of average earning assets | 3.05% | 2.96% | 3.29% | 3.08% | 3.23% |
| Net (recoveries)/charge-offs as a percentage of average net loans and dealer notes | (0.58%) | (0.03%) | (0.01%) | 0.11% | 1.14% |

At Year End

| | | | | | |
|---------------------------------------------------------------------|--------|--------|--------|--------|--------|
| Shareholders' equity as a percentage of total assets | 19.34% | 23.00% | 26.04% | 26.31% | 26.14% |
| Debt as a ratio to shareholders' equity | 4.17:1 | 3.35:1 | 2.84:1 | 2.80:1 | 2.83:1 |
| Allowance for loan losses as a percentage of loans and dealer notes | 0.64% | 0.60% | 0.75% | 0.78% | 0.99% |
| Permanent capital ratio | 18.95% | 23.14% | 25.01% | 26.40% | 25.63% |
| Core surplus ratio | 18.56% | 21.72% | 23.83% | 24.66% | 23.41% |
| Total surplus ratio | 18.56% | 22.64% | 24.43% | 25.77% | 24.92% |

Net Income Distribution

| | | | | | |
|-----------------------------------|----------|----------|----------|----------|----------|
| Cash patronage distributions paid | \$ 2,003 | \$ 1,953 | \$ 1,500 | \$ 1,497 | \$ 1,000 |
| Patronage distributions payable | \$ 2,000 | \$ 2,003 | \$ 1,957 | \$ 1,500 | \$ 1,500 |

Other

| | | | | | |
|-------------------------------------|--------|--------|--------|--------|--------|
| Loans serviced for U.S. AgBank, FCB | \$ 152 | \$ 274 | \$ 332 | \$ 414 | \$ 538 |
|-------------------------------------|--------|--------|--------|--------|--------|

MANAGEMENT'S DISCUSSION AND ANALYSIS

(Dollars in thousands, except as noted)

INTRODUCTION

The following discussion summarizes the financial position and results of operations of Farm Credit of Western Oklahoma, ACA for the year ended December 31, 2008. Comparisons to prior years are included. We have emphasized material known trends, commitments, events, or uncertainties that have impacted, or are reasonably likely to impact our financial condition and results of operations. You should read these comments along with the accompanying financial statements, footnotes and other sections of this report. The accompanying financial statements were prepared under the oversight of our Audit Committee. The Management's Discussion and Analysis includes the following sections:

- Business Overview
- Economic Overview
- Loan Portfolio
- Credit Risk Management
- Results of Operations
- Liquidity
- Capital Resources
- Regulatory Matters
- Governance
- Forward-Looking Information
- Critical Accounting Policies and Estimates
- Customer Privacy

Our quarterly reports to shareholders are available approximately 40 days after the calendar quarter end and annual reports are available approximately 75 days after the calendar year end. The reports may be obtained free of charge on our website, www.fcwestok.com, or upon request. We are located at 3302 Williams Avenue, Woodward, Oklahoma 73801 or may be contacted by calling (580) 256-3465 or (800) 299-3465.

BUSINESS OVERVIEW

Farm Credit System Structure and Mission

We are one of the more than 90 associations in the Farm Credit System (System), which was created by Congress in 1916 and has served agricultural producers for over 90 years. The System mission is to provide sound and dependable credit to American farmers, ranchers, and producers or harvesters of aquatic products and farm-related businesses through a member-owned cooperative system. This is done by making loans and providing financial services. Through its commitment and dedication to agriculture, the System continues to have the largest portfolio of agricultural loans of any lender in the United States. The Farm Credit Administration (FCA) is the System's independent safety and soundness federal regulator and was established to supervise, examine and regulate System institutions.

Our Structure and Focus

As a cooperative, we are owned by the members we serve. The territory served extends across a diverse agricultural region from the Black Mesa in the northwest part of the Panhandle in Cimarron County to near Carnegie in the southeast part of Washita County in Oklahoma. The counties in our territory are listed in Note 1 of the accompanying financial statements. We make production and intermediate-term loans for agricultural production or operating purposes and long-term real estate mortgage loans to farmers, ranchers, rural residents and agribusinesses. Additionally, we provide other related services to our borrowers. Our success begins with our extensive agricultural experience and knowledge of the market and is dependent on the level of satisfaction we can provide to our borrowers.

We obtain the funding for our lending and operations from U.S. AgBank, FCB (AgBank). AgBank is a cooperative of which we are a member. AgBank, its related associations, and AgVantis, Inc. (AgVantis) are referred to as the District. We are materially affected by AgBank's financial condition and results of operations. The U.S. AgBank and U.S. AgBank District quarterly and annual reports are available on AgBank's website, www.usagbank.com, or may be obtained at no charge by calling (800) 322-9880. Annual reports are available within 75 days after year end and quarterly reports are available within 40 days after the calendar quarter end.

We purchase technology and other operational services from AgVantis, which is a technology service corporation. Our current Services Agreement with AgVantis expires on January 1, 2010. We are a shareholder in AgVantis, along with all other AgVantis customers. Beginning in 2008, Farm Credit Foundations, a human resource service provider for a number of Farm Credit institutions, provided our payroll and human resource services.

ECONOMIC OVERVIEW

In general, agriculture has continued to experience a long period of favorable economic conditions with record farm income forecasted for 2008 due to favorable commodity prices. Agriculture, however, remains a cyclical business, and agricultural economic conditions may be less favorable in the future. Specifically, high energy and fertilizer costs, higher feed costs, labor costs and availability, water costs and availability, increased market interest rates, adverse weather conditions and commodity price volatility can negatively impact the profitability of agricultural producers. Financial adversity for our customers would be reflected in our future credit quality measures and financial performance results.

Recent economic events have created substantial turmoil in the financial sector and uncertainty in the credit markets. This has resulted in failures, such as the bankruptcy of Lehman Brothers, and a government conservatorship of two housing government sponsored enterprises (GSEs), Fannie Mae and Freddie Mac. Although the Farm Credit System is also a GSE, our charter is significantly different from that of the housing GSEs as our primary business is to serve the credit needs of agriculture and rural America. Further, as a cooperative, we are owned by our customers, which is a substantially different structure than the housing GSEs. Although the volatile financial market environment has negatively impacted our cost of funding as funding spreads have increased, we have been able to fund loans to our farmer and rancher customers in response to loan demand.

Economic conditions in our region were favorable during most of 2008. Profit margins were strong despite increased input costs during most of the year and volatile commodity prices. However, profit margins decreased in the beef sector by year-end. Commodity prices declined 30%-40% by year-end, but input costs have not declined by the same proportion. Agriculture has had nearly ten years of strong earnings, and going into these volatile times, both customer balance sheets and our balance sheet have good capital and risk bearing ability.

Weather conditions during most of 2008 were favorable with most crop yields at or above average. However, dry weather conditions in fourth quarter have put stress on the winter wheat crop.

LOAN PORTFOLIO

Total loan volume was \$322,796 at December 31, 2008, an increase of \$68,255, or 26.81%, from loans at December 31, 2007 of \$254,541, and \$107,432, or 49.88%, from loans at December 31, 2006 of \$215,364. The increase in loans was due to increased participations and customer demand. The types of loans outstanding at December 31 are reflected in the following table.

| | 2008 | | 2007 | | 2006 | |
|----------------------------------|------------|---------|------------|---------|------------|---------|
| | Volume | Percent | Volume | Percent | Volume | Percent |
| Real estate mortgage | \$ 196,023 | 60.73% | \$ 163,534 | 64.25% | \$ 149,293 | 69.32% |
| Production and intermediate-term | 121,036 | 37.50% | 87,870 | 34.52% | 63,088 | 29.29% |
| Agribusiness: | | | | | | |
| Loans to cooperatives | 1,395 | 0.43% | — | — | — | — |
| Processing and marketing | 2,145 | 0.66% | 1 | — | — | — |
| Farm related business | 750 | 0.23% | 1,144 | 0.45% | 877 | 0.41% |
| Rural residential real estate | 1,447 | 0.45% | 1,992 | 0.78% | 2,106 | 0.98% |
| Total | \$ 322,796 | 100.00% | \$ 254,541 | 100.00% | \$ 215,364 | 100.00% |

In 2008, real estate mortgage volume increased to \$196,023, compared with \$163,534 at year-end 2007, primarily due to increased loan demand and property values. These long-term mortgage loans are primarily used to purchase, refinance or improve real estate. These loans have maturities ranging from 5 to 40 years. Real estate mortgage loans are also made to rural homeowners. By law, a real estate mortgage loan must be secured by a first lien and may only be made in an amount up to 85% of the original appraised value of the property, or up to 97% of appraised value, if the loan is guaranteed by certain state, federal, or other governmental agencies. Refer to Note 3 of the Notes to the Consolidated Financial Statements for more detail.

The production and intermediate-term volume increased 37.74% to \$121,036 compared with 2007 loan volume of \$87,870 primarily due to higher input costs, cross selling to mortgage customers and an increase in participation interests purchased as a result of reciprocal relationships developed from the increase in participation loan interests

sold. Production loans are used to finance the ongoing operating needs of agricultural producers. Production loans generally match the borrower's normal production and marketing cycle, which is typically 12 months. Intermediate-term loans are typically used to finance depreciable capital assets of a farm or ranch. Intermediate-term loans are written for a specific term, 1 to 15 years, with most loans being less than 10 years.

Approximately 9% of real estate mortgage volume, 38% of production and intermediate-term volume, and 100% of processing and marketing volume were purchased interests in loans.

Portfolio Diversification

While we make loans and provide financially related services to qualified borrowers in agricultural and rural sectors and to certain related entities, our loan portfolio is diversified by participations purchased and sold, geographic locations served and commodities financed, as illustrated in the following three tables.

We purchase participation interests in loans from other System and non-System entities to generate additional earnings and diversify risk related to existing commodities financed and our geographic area served. In addition, we sell a portion of certain large loans to other System and non-System entities to reduce risk and comply with lending limits we have established. The volume of participations purchased and sold as of December 31 follows.

| | 2008 | 2007 | 2006 |
|--------------------------|-----------|-----------|-----------|
| Participations purchased | \$ 66,621 | \$ 27,799 | \$ 20,002 |
| Participations sold | \$ 19,615 | \$ 6,002 | \$ 7,385 |

The geographic distribution of loans by county at December 31 follows. As previously mentioned we purchase loan interests outside our territory. These participations purchased are included in Other in the following table.

| | 2008 | 2007 | 2006 |
|-------------|---------|---------|---------|
| Beaver | 3.65% | 3.71% | 3.78% |
| Beckham | 1.78% | 2.10% | 1.88% |
| Cimarron | 3.56% | 3.79% | 4.67% |
| Custer | 5.36% | 5.68% | 5.80% |
| Dewey | 5.21% | 5.04% | 5.03% |
| Ellis | 3.08% | 3.90% | 5.07% |
| Harper | 7.52% | 8.34% | 6.87% |
| Roger Mills | 4.65% | 6.41% | 5.67% |
| Texas | 9.81% | 10.37% | 12.78% |
| Washita | 6.81% | 8.02% | 9.70% |
| Woods | 7.87% | 8.98% | 6.13% |
| Woodward | 7.60% | 8.92% | 10.51% |
| Other | 33.10% | 24.74% | 22.11% |
| Total | 100.00% | 100.00% | 100.00% |

The increase in Other is due to the increase in participation loan interests purchased outside of our territory.

We are party to a Territorial Approval Agreement (Agreement) with other associations in the states of Oklahoma, Colorado, Kansas and New Mexico. The Agreement eliminates territorial restrictions and allows associations that are a party to the Agreement to make loans in any other association's territory regardless of a borrower's place of residence, location of operations, location of loan security or location of a headquarters. This Agreement can be terminated upon the earlier to occur of:

- 1) the time when all but one association has withdrawn as a party to the Agreement; or
- 2) December 31, 2025, or
- 3) when requested by FCA.

Commodity and industry categories are based on the Standard Industrial Classification System (SIC) published by the federal government. This system is used to assign commodity or industry categories based on the primary business of the customer. A primary business category is assigned when the commodity or industry accounts for 50% or more of the total value of sales for its products; however, generally a large percentage of agricultural operations include more than one commodity. The following table shows the primary agricultural commodities produced by our borrowers as of December 31.

| | 2008 | 2007 | 2006 |
|------------------------------------|----------------|----------------|----------------|
| Beef | 62.46% | 47.61% | 43.57% |
| Wheat | 11.77% | 11.98% | 14.56% |
| Cash Grain/Corn/Sorghum | 11.65% | 10.26% | 10.06% |
| Peanuts /Cotton/Peppers/Watermelon | 1.88% | 2.95% | 4.29% |
| Dairy | 1.86% | 0.32% | 0.41% |
| Landlords | 1.57% | 0.79% | 0.94% |
| Hay | 1.46% | 0.72% | 0.66% |
| Poultry | 1.39% | 0.52% | – |
| Hogs | 1.21% | 1.60% | 1.99% |
| Other | 4.75% | 23.25% | 23.52% |
| Total | 100.00% | 100.00% | 100.00% |

Our loan portfolio contains a concentration of cattle, wheat and various other grain producers. Repayment ability of our borrowers is closely related to the production and profitability of the commodities they raise. If a loan fails to perform, restructuring and/or other servicing alternatives are influenced by the underlying value of the collateral which is impacted by industry economics. While we are committed to maintaining sound credit quality, our future performance would be negatively impacted by adverse agricultural conditions. The degree of the adverse impact would be correlated to the commodities impacted and the magnitude and duration of the adverse agricultural conditions to our borrowers.

In addition to commodities, diversification is also achieved from loans to rural residents and part-time farmers which typically derive most of their earnings from non-agricultural sources. These borrowers are less subject to agricultural cycles and would likely be more affected by weaknesses in the general economy. In previous periods, these borrowers were reported in the group “Other” but have been re-categorized based on the primary agriculture product produced. The change primarily resulted in an increase in the beef commodity. Of our loan volume at December 31, 2008, approximately 31% consists of borrowers with income not solely from agricultural sources, an increase from 16% for 2007, and 19% for 2006.

Small loans (less than \$250 thousand) accounted for 35.96% of loan volume at December 31, 2008. Credit risk on small loans, in many instances, is reduced by non-farm income sources. The table below details the loan principal by dollar size.

| (Range in thousands) | December 31, 2008 | | December 31, 2007 | |
|----------------------|--------------------|-----------------|--------------------|-----------------|
| | Amount outstanding | Number of loans | Amount outstanding | Number of loans |
| \$1 - \$250 | \$ 116,063 | 1,893 | \$ 113,174 | 1,926 |
| \$251 - \$500 | 37,843 | 112 | 32,915 | 98 |
| \$501 - \$1,000 | 41,528 | 57 | 33,735 | 48 |
| \$1,001 - \$5,000 | 121,536 | 59 | 68,891 | 36 |
| \$5,001 - \$25,000 | 5,826 | 1 | 5,826 | 1 |
| Total | \$ 322,796 | 2,122 | \$ 254,541 | 2,109 |

Approximately 25% of our loan volume is attributable to 16 borrowers. The loss of any of these loans or the failure of any of these loans to perform would adversely affect the portfolio and our future operating results.

Credit Commitments

We may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of our borrowers and to manage our exposure to interest rate risk. These financial instruments include commitments to extend credit. The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in our consolidated 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. Commitments and letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee by the borrower. The following table summarizes the maturity distribution of unfunded credit commitments on loans at December 31, 2008.

| | Less than 1 year | 1 – 3 years | 3 – 5 years | Over 5 years | Total |
|------------------------------|------------------|------------------|---------------|---------------|------------------|
| Commitments to extend credit | \$ 49,679 | \$ 27,813 | \$ 387 | \$ 818 | \$ 78,697 |
| Standby letters of credit | 17 | 30 | 15 | – | 62 |
| Total commitments | \$ 49,696 | \$ 27,843 | \$ 402 | \$ 818 | \$ 78,759 |

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 contractual amounts are not reflected on the Consolidated Statement of Condition 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 we apply the same credit policies to these commitments. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on our credit evaluation of the borrower. No material losses are anticipated as a result of these credit commitments.

High Risk Assets

Nonperforming loan volume is comprised of nonaccrual, restructured, and loans 90 days past due still accruing interest and are referred to as impaired loans. High risk assets consist of impaired loans and other property owned. Year-end comparative information regarding high risk assets in the portfolio, including accrued interest, follows:

| | 2008 | 2007 | 2006 |
|------------------------------------------------|----------|----------|----------|
| Nonaccrual loans: | | | |
| Real estate mortgage | \$ 821 | \$ 3,166 | \$ 1,183 |
| Production and intermediate-term | 4,582 | 561 | 81 |
| Agribusiness | 5 | 18 | 26 |
| Rural residential real estate | – | – | 61 |
| Total nonaccrual loans | 5,408 | 3,745 | 1,351 |
| Accruing restructured loans: | | | |
| Real estate mortgage loans | 189 | 392 | 546 |
| Total high risk assets | \$ 5,597 | \$ 4,137 | \$ 1,897 |
| Nonaccrual loans to total loans | 1.68% | 1.47% | 0.63% |
| High risk assets to total loans | 1.73% | 1.63% | 0.88% |
| High risk assets to total shareholders' equity | 8.47% | 6.60% | 3.13% |

We had no loans classified as 90 days past due still accruing interest and no other property owned for the years presented.

Total high risk assets increased \$1,460, or 35.29%, to \$5,597 at December 31, 2008 compared with year-end 2007. High risk asset volume is anticipated to increase in the future due to the volatility in the economic environment.

Nonaccrual loans represent all loans where there is a reasonable doubt as to collection of principal and/or interest. Nonaccrual volume increased \$1,663 compared with December 31, 2007. Nonaccrual production and intermediate-term loan volume increased during the fourth quarter primarily due to the transfer of one large loan participation as a result of pressures brought on by higher corn prices that adversely impacted borrowers in the livestock/poultry industries. Real estate mortgage nonaccrual volume decreased due to the collection of a large nonaccrual loan. The following table provides additional information on nonaccrual loans as of December 31.

| | 2008 | 2007 | 2006 |
|-------------------------------------------------|----------|----------|----------|
| Nonaccrual current as to principal and interest | \$ 5,408 | \$ 3,303 | \$ 1,264 |
| Cash basis nonaccrual loans | \$ – | \$ – | \$ 151 |

For the years presented, we had no restructured loans in nonaccrual status.

Accruing restructured loans, including related accrued interest, decreased \$203 during 2008 primarily as a result of repayments. The restructured loans include only the year-end balances of loans and related accrued interest on which monetary concessions have been granted to borrowers and that are in accrual status. Restructured loans do not include loans on which extensions or other non-monetary concessions have been granted, or restructured loans on which monetary concessions have been granted but which remain in nonaccrual status.

Credit Quality

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

- Acceptable – Assets are expected to be fully collectible and represent the highest quality.
- Other Assets Especially Mentioned (OAEM) – Assets are currently collectible but exhibit some potential weakness.

- Substandard – Assets exhibit some serious weakness in repayment capacity, equity, and/or collateral pledged on the loan.
- Doubtful – Assets exhibit similar weaknesses to substandard assets. However, doubtful assets have additional weaknesses in existing facts that make collection in full highly questionable.
- Loss – Assets are considered uncollectible.

The following table presents statistics related to the credit quality of the loan portfolio, including accrued interest, classified under the UCS at December 31.

| | 2008 | 2007 | 2006 |
|-------------|---------|---------|---------|
| Acceptable | 95.71% | 95.63% | 95.61% |
| OAEM | 1.50% | 2.27% | 2.89% |
| Substandard | 2.79% | 2.10% | 1.50% |
| Total | 100.00% | 100.00% | 100.00% |

During 2008, overall credit quality declined. Loans classified as "Acceptable" and "OAEM" were 97.21% at December 31, 2008, and 97.90% at December 31, 2007. We had no loans classified as "Doubtful" or "Loss" for the years presented. Loan delinquencies (accruing loans 30 days or more past due) as a percentage of accruing loans decreased and remained at a low level of 0.04% at December 31, 2008, compared with 0.09% at December 31, 2007. The financial position of most agricultural producers has strengthened during the past decade. With borrowers' strong financial positions and the continued emphasis on sound underwriting standards, the credit quality of our loan portfolio remains strong. Agriculture remains a cyclical business that is heavily influenced by production, operating costs and commodity prices. While credit quality is anticipated to remain sound in 2009, we expect that less favorable economic conditions and less government support programs could lead to future weakening in the loan portfolio to a level more consistent with historical averages.

Allowance for Loan Losses

We maintain an allowance for loan losses at a level consistent with the probable losses identified by management. The allowance for loan losses at each period end was considered to be adequate to absorb probable losses existing in the loan portfolio. Because the allowance for loan losses considers factors such as current agricultural and economic conditions, loss experience, portfolio quality and loan portfolio composition, there will be a direct impact to the allowance for loan losses and our income statement when there is a change in any of those factors. The following provides relevant information regarding the allowance for loan losses as of December 31.

| | 2008 | 2007 | 2006 |
|-------------------------------------|----------|----------|----------|
| Balance at beginning of year | \$ 1,523 | \$ 1,620 | \$ 1,621 |
| Charge-offs: | | | |
| Production and intermediate-term | 14 | 16 | 21 |
| Recoveries: | | | |
| Production and intermediate-term | – | 81 | 19 |
| Agribusiness | 1,631 | – | 30 |
| Net recoveries | (1,617) | (65) | (28) |
| Loan loss reversal | (1,071) | (162) | (29) |
| Balance at December 31 | \$ 2,069 | \$ 1,523 | \$ 1,620 |
| Net recoveries to average net loans | (0.58%) | (0.03%) | (0.01%) |

The following table presents the allowance for loan losses by loan type as of December 31.

| | 2008 | 2007 | 2006 |
|----------------------------------|----------|----------|----------|
| Real estate mortgage | \$ 207 | \$ 338 | \$ 252 |
| Production and intermediate-term | 1,815 | 1,179 | 1,360 |
| Agribusiness | 46 | 4 | 1 |
| Rural residential real estate | 1 | 2 | 7 |
| Total | \$ 2,069 | \$ 1,523 | \$ 1,620 |

The allowance for loan losses increased \$546 from December 31, 2007, to \$2,069 at December 31, 2008. The increase in allowance for loan losses was primarily due to the net recovery of \$1,617, partially offset by a net loan loss reversal of \$1,071. A loan loss reversal was recorded during first quarter 2008 due to a recovery on one loan. A provision for loan losses of \$783 was recorded during fourth quarter 2008 primarily due to volatility in the

poultry/livestock industry. Comparative allowance for loan losses coverage as a percentage of loans and certain other credit quality indicators as of December 31 is shown in the following table.

| | 2008 | 2007 | 2006 |
|-------------------------------|--------|--------|---------|
| Allowance as a percentage of: | | | |
| Loans | 0.64% | 0.60% | 0.75% |
| Impaired loans | 36.97% | 36.81% | 85.40% |
| Nonaccrual loans | 38.26% | 40.67% | 119.91% |

Young, Beginning and Small Farmers and Ranchers Program

As part of the Farm Credit System, we are committed to providing sound and constructive credit and related services to young, beginning and small (YBS) farmers and ranchers. We continually strive to develop business relationships with young, beginning and small farmers and ranchers who exhibit the management skills necessary to build a solid financial position, have viable operations, contribute to the agricultural community and become profitable customers. The FCA regulatory definitions for YBS farmers and ranchers are shown below.

- Young Farmer: A farmer, rancher, or producer or harvester of aquatic products who was age 35 or younger as of the date the loan was originally made.
- Beginning Farmer: A farmer, rancher, or producer or harvester of aquatic products who had 10 years or less farming or ranching experience as of the date the loan was originally made.
- Small Farmer: A farmer, rancher, or producer or harvester of aquatic products who normally generated less than \$250 thousand in annual gross sales of agricultural or aquatic products at the date the loan was originally made.

The following table outlines our percentage of YBS loans as a percentage of our loan portfolio (by number) as of December 31. The USDA column represents the percent of farmers and ranchers classified as YBS within our territory per the 2002 USDA Agricultural Census, which is the most current data available. A loan may be included in more than one category.

| | USDA | 2008 | 2007 | 2006 |
|-----------|--------|--------|--------|--------|
| Young | 6.50% | 19.60% | 20.02% | 18.10% |
| Beginning | 26.50% | 22.70% | 21.38% | 18.90% |
| Small | 95.70% | 64.66% | 65.52% | 63.00% |

We establish annual marketing goals to increase market share of loans to YBS farmers and ranchers. Our goals are as follows:

- Enhance and expand the use of our YBS Advisory Committee;
- Offer related services either directly or in coordination with others that are responsive to the needs of YBS farmers and ranchers in our territory;
- Take full advantage of opportunities for coordinating credit and services offered with other system institutions in the territory and other governmental and private sources of credit who offer credit and services to those who qualify as YBS farmers and ranchers in our territory; and,
- Implement effective outreach programs to attract YBS farmers and ranchers.

Quarterly reports are provided to our Board of Directors detailing the number, volume and credit quality of our YBS customers. We have developed quantitative targets to monitor our progress.

- Loan volume and loan number goals for YBS farmers and ranchers in your territory;
- Percentage goals representative of the demographics of YBS farmers and ranchers in your territory;
- Percentage goals for loans made to new borrowers qualifying as YBS farmers and ranchers in your territory; and,
- Goals for capital committed to loans made to YBS farmers and ranchers in your territory.

| | New Lending | | Total Portfolio | |
|-----------|-------------|--------|-----------------|----------|
| | Goal | Actual | Goal | Actual |
| Young | \$ 150 | \$ 122 | \$ 440 | \$ 417 |
| Beginning | \$ 195 | \$ 150 | \$ 475 | \$ 483 |
| Small | \$ 370 | \$ 332 | \$ 1,400 | \$ 1,376 |

To ensure that credit and services offered to our YBS farmers and ranchers are provided in a safe and sound manner and within our risk-bearing capacity, we utilize customized loan underwriting standards, loan guarantee programs, fee

waiver programs, or other credit enhancement programs. Additionally, we are actively involved in developing and sponsoring educational opportunities, leadership training, business financial training and insurance services for YBS farmers and ranchers.

CREDIT RISK MANAGEMENT

Credit risk arises from the potential failure of a borrower to meet repayment obligations that result in a financial loss to the lender. Credit risk exists in our loan portfolio and also in our unfunded loan commitments and standby letters of credit. Credit risk is actively managed on an individual and portfolio basis through application of sound lending and underwriting standards, policies and procedures.

Underwriting standards are developed and utilized to determine an applicant's operational, financial, and management resources available for repaying debt within the terms of the note or loan agreement. Underwriting standards include among other things, an evaluation of:

- character – borrower integrity and credit history;
- capacity – repayment capacity of the borrower based on cash flows from operations or other sources of income;
- collateral – to protect the lender in the event of default and also serve as a secondary source of loan repayment;
- capital – ability of the operation to survive unanticipated risks; and,
- conditions – including use of the loan funds, terms, restrictions, etc.

Processes for information gathering, balance sheet and income statement verification, loan analysis, credit approvals, disbursements of proceeds and subsequent loan servicing actions are established and followed. Underwriting standards vary by industry and are updated periodically to reflect market and industry conditions.

By regulation, we cannot have loan commitments to one borrower for more than 25% of our permanent capital. Through lending delegations, AgBank further restricts individual loan size limits to one borrower to 15% of permanent capital. Within these parameters, we set our own lending limits to manage loan concentration risk. Lending limits are established for individual loan size, commodity type, special lending programs and geographic concentrations. We have adopted an individual loan size maximum of 12% of permanent capital for our highest quality borrowers.

We have established internal lending delegations to properly control the loan approval process. Delegations to staff are based on our risk-bearing ability, loan size, complexity, type and risk, as well as the expertise of the credit staff member. Larger and more complex loans are typically approved by our loan committee with the most experienced and knowledgeable credit staff serving as members.

The majority of our lending is first mortgage real estate lending which must be secured by a first lien. Production and intermediate-term lending accounts for most of the remaining volume and is typically secured. Collateral evaluations are made within FCA and Uniform Standards of Professional Appraisal Practices requirements. All property is appraised at market value. All collateral evaluations must be performed by a qualified appraiser. Certain appraisals must be performed by individuals with a state certification or license.

We use a Combined System Risk Model (Model) which is a two-dimensional risk rating system that estimates each loan's probability of default and loss given default. The Model uses objective and subjective criteria to identify inherent strengths, weaknesses, and risks in each loan. The Model is utilized in loan and portfolio management processes. It is also used in allowance for loan losses estimates, as it contains much more portfolio granularity, particularly related to acceptable loan classification under the Uniform Classification System (UCS). The Model's 14-point scale provides for nine acceptable categories, one OAEM category, two substandard categories, one doubtful category and one loss category. In addition, this Model serves as the basis for economic capital modeling.

RESULTS OF OPERATIONS**Earnings Summary**

In 2008, we recorded net income of \$5,431, compared with \$3,993 in 2007, and \$3,933 in 2006. The increase in 2008 was primarily due to an increase in net interest income and a loan loss reversal, partially offset by an increase in noninterest expense. The following table presents the changes in the significant components of net income from the previous year.

| | 2008 vs. 2007 | 2007 vs. 2006 |
|--------------------------------------|---------------|---------------|
| Net income, prior year | \$ 3,993 | \$ 3,933 |
| Increase/(Decrease) from changes in: | | |
| Interest income | 1,298 | 1,370 |
| Interest expense | 374 | (1,387) |
| Net interest income | 1,672 | (17) |
| Loan loss reversal | 909 | 133 |
| Noninterest income | (122) | 168 |
| Noninterest expense | (1,013) | (193) |
| Provision for income taxes | (8) | (31) |
| Total increase in net income | 1,438 | 60 |
| Net income, current year | \$ 5,431 | \$ 3,993 |

Net Interest Income

Net interest income for 2008 was \$8,607 compared with \$6,935 for 2007 and \$6,952 for 2006. The table below provides an analysis of the individual components of the change in net interest income during 2008 and 2007.

| | 2008 vs. 2007 | 2007 vs. 2006 |
|-------------------------------------------------------------|---------------|---------------|
| Net interest income, prior year | \$ 6,935 | \$ 6,952 |
| Increase/(Decrease) in net interest income from changes in: | | |
| Interest rates earned | (2,554) | (215) |
| Interest rates paid | 2,289 | (262) |
| Volume of accruing assets/interest bearing liabilities | 1,275 | 378 |
| Interest income on nonaccrual loans | 662 | 82 |
| Increase/(Decrease) in net interest income | 1,672 | (17) |
| Net interest income, current year | \$ 8,607 | \$ 6,935 |

The following table illustrates net interest margin and the average interest rates on loans and debt cost and interest rate spread.

| | Year Ended December 31 | | |
|----------------------|------------------------|-------|-------|
| | 2008 | 2007 | 2006 |
| Net interest margin | 3.05% | 2.96% | 3.29% |
| Interest rate on: | | | |
| Average loan volume | 6.40% | 7.17% | 7.29% |
| Average debt | 4.15% | 5.40% | 5.24% |
| Interest rate spread | 2.25% | 1.77% | 2.05% |

The increase in interest rate spread resulted from a 77 basis point decrease in interest rate on average loan volume and a 125 basis point decrease in interest rates on average debt. Net interest margin increased primarily due to \$662 of nonaccrual income recorded during 2008.

Loan Loss Reversals

We review our loan portfolio on a regular basis to determine if any increase through provision for loan losses or decrease through a loan loss reversal in our allowance for loan losses is necessary based on our assessment of the probable losses in our loan portfolio. We recorded a loan loss reversal of \$1,071 in 2008, \$162 in 2007 and \$29 in 2006. The loan loss reversal recorded during 2008 was primarily due to a recovery on one loan. A provision for loan losses was recorded during fourth quarter due to volatility in the poultry/livestock industry.

Noninterest Income

During 2008, we recorded noninterest income of \$1,717, compared with \$1,839 in 2007 and \$1,671 in 2006. Patronage distributions from AgBank are our primary source of noninterest income. Beginning January 1, 2007, all AgBank patronage distributions were paid in cash. The components of the patronage from AgBank are reflected in the following table for each of the three years ended December 31.

| | Year Ended December 31 | | |
|-----------------------------|------------------------|----------|----------|
| | 2008 | 2007 | 2006 |
| Cash patronage | \$ 1,268 | \$ 1,481 | \$ 1,103 |
| Stock patronage | – | – | 337 |
| Total patronage from AgBank | \$ 1,268 | \$ 1,481 | \$ 1,440 |

Noninterest income also includes loan fees, financially related services income and other noninterest income. Loan fees in 2008 were \$62, an increase of \$25, from 2007, primarily due to unused commitment fees from participation loans and increased loan conversion activity. Financially related services income increased from \$248 in 2007 to \$299 in 2008 due to increased demand for crop insurance.

Noninterest Expense

Noninterest expense for 2008, increased \$1,013, or 20.55%, to \$5,943 compared with 2007. Significant components of noninterest expense for each of the three years ended December 31 are compared in the following table.

| | Year Ended December 31 | | | Percent of Change | |
|------------------------------------|------------------------|----------|----------|-------------------|-----------|
| | 2008 | 2007 | 2006 | 2008/2007 | 2007/2006 |
| Salaries & employee benefits | \$ 2,883 | \$ 2,356 | \$ 2,404 | 22.37% | (2.00%) |
| Occupancy & equipment | 417 | 397 | 322 | 5.04% | 23.29% |
| Purchased services from AgVantis | 324 | 288 | 291 | 12.50% | (1.03%) |
| Supervisory & examination costs | 93 | 91 | 93 | 2.20% | (2.15%) |
| Other | 1,807 | 1,460 | 1,323 | 23.77% | 10.36% |
| Total operating expense | 5,524 | 4,592 | 4,433 | 20.30% | 3.59% |
| Farm Credit Insurance Fund premium | 419 | 338 | 304 | 23.96% | 11.18% |
| Total noninterest expense | \$ 5,943 | \$ 4,930 | \$ 4,737 | 20.55% | 4.07% |

For the year ended December 31, 2008, total operating expense increased \$932, or 20.30%, compared to the year ended December 31, 2007. Salary and employee benefits increased due to normal merit increases and an increase in the number of employees during 2008. Also, the pension and postretirement plans were amended in 2007, which resulted in the immediate recognition of \$115 recorded as a decrease to salaries and employee benefits expense. Other increased primarily due to increased travel, public relations, segregation of the appraisal function and expenses related to the branch office opened in 2008. These expenses enable us to continue to provide high quality customer service and quality loan servicing to help mitigate risk in our portfolio.

Insurance Fund premium increased \$81 to \$419 due to an increase in the premiums rate and an increase in volume. As of July 1, 2008, the Farm Credit System Insurance Corporation began charging premiums based on debt rather than loan volume. Rates were increased to 15 basis points on debt for the third quarter of 2008 and to 18 basis points for the fourth quarter of 2008. Rates were 15 basis points on average loan volume in the first half of 2008 and for the full year in 2007 and 2006.

LIQUIDITY

Liquidity is necessary to meet our financial obligations. Obligations that require liquidity include paying our note with AgBank, funding loans and other commitments, and funding operations in a cost-effective manner. Our liquidity policy is intended to manage short-term cash flow and maximize debt reduction. Our direct loan with AgBank, cash on hand and loan repayments provide adequate liquidity to fund our on-going operations and other commitments. Even with the volatility in the financial markets, we anticipate liquidity levels will be adequate to meet our obligations.

Funding Sources

Our primary source of liquidity is the ability to obtain funds for operations through a borrowing relationship with AgBank. Our note payable to AgBank is collateralized by a pledge to AgBank of substantially all of our assets. Substantially all cash received is applied to the note payable and all cash disbursements are drawn on the note payable. The indebtedness is governed by a General Financing Agreement (GFA). The GFA is subject to renewal at

its expiration date of April 30, 2012 in accordance with normal business practices. The annual average principal balances of the note payable to AgBank were \$224,998 in 2008, \$179,310 in 2007 and \$159,050 in 2006.

We plan to continue to fund lending operations through the utilization of our borrowing relationship with AgBank, retained earnings from current and prior years and from borrower stock investment. AgBank's primary source of funds is the ability to issue Systemwide Debt Securities to investors through the Federal Farm Credit Bank Funding Corporation. Historically, this access has provided a dependable source of competitively priced debt that is critical for supporting our mission of providing credit to agriculture and rural America. Although financial markets have experienced significant volatility, we anticipate continued access to the funding necessary to support our lending and business operations.

Interest Rate Risk

The interest rate risk inherent in our loan portfolio is substantially mitigated through our funding relationship with AgBank which allows for loans to be match-funded. Borrowings from AgBank match the pricing, maturity, and option characteristics of our loans to borrowers. AgBank manages interest rate risk through the direct loan pricing and their asset/liability management processes. Although AgBank incurs and manages the primary sources of interest rate risk, we may still be exposed to interest rate risk through the impact of interest rate changes on earnings generated from our loanable funds. To stabilize earnings from loanable funds, we have committed excess funds with AgBank at a fixed rate as a part of AgBank's Earnings Stabilization Management Program (ESMP). This enables us to stabilize earnings without significantly increasing our overall interest rate risk position.

Our ESMP commitment balance was \$1,000 and matures in one year or more with an average interest rate of 5.30% as of December 31, 2008.

Funds Management

We offer variable, fixed, adjustable prime-based and LIBOR-based rate loans to borrowers. Our Asset/Liability Committee determines the interest rate charged based on the following factors: 1) the interest rate charged by AgBank; 2) our existing rates and spreads; 3) the competitive rate environment; and 4) our profitability objectives.

CAPITAL RESOURCES

Capital supports asset growth and provides protection for unexpected credit and operating losses. Capital is also needed for investments in new products and services. We believe a sound capital position is critical to our long-term financial success due to the volatility and cycles in agriculture.

Over the past several years, we have been able to build capital primarily through net income retained after patronage. Shareholders' equity at December 31, 2008 totaled \$66,074, compared with \$62,683 at December 31, 2007 and \$60,693 at December 31, 2006. Capital includes stock purchased by our borrowers and retained earnings accumulated through net income less patronage distributed to borrowers. Our capital position is reflected in the following ratio comparisons.

| | 2008 | 2007 | 2006 |
|---------------------------------------------|--------|--------|--------|
| Debt to shareholders' equity | 4.17:1 | 3.35:1 | 2.84:1 |
| Shareholders' equity as a percent of loans | 20.47% | 24.63% | 28.18% |
| Shareholders' equity as a percent of assets | 19.34% | 23.00% | 26.04% |

Debt to shareholders' equity increased and shareholders' equity as a percent of loans and of total assets decreased from 2007 to 2008 primarily due to increased loan volume.

Retained Earnings

Our retained earnings increased \$3,431 to \$64,799 at December 31, 2008 from \$61,368 at December 31, 2007. The increase was a result of net income of \$5,431, partially offset by \$2,000 of patronage distributions declared.

Patronage Program

We have a Patronage Program that allows us to distribute our available net earnings to our shareholders. This program provides for the application of net earnings in the manner described in our Bylaws. In addition to determining the amount and method of patronage to be distributed, this includes increasing surplus to meet capital adequacy standards established by Regulations; increasing surplus to a level necessary to support competitive pricing at targeted earnings levels; and increasing surplus for reasonable reserves. Patronage distributions are based on business done with us during the year. We paid patronage distributions of \$2,003 in 2008, \$1,953 in 2007 and \$1,500 in 2006.

Stock

Our total stock decreased \$40 to \$1,275 at December 31, 2008, from \$1,315 at December 31, 2007. We require a stock investment for each borrower. The current initial investment requirement is the lesser of one thousand dollars or 2.00% of the collective total balance of each borrower's loan(s).

Capital Plan and Regulatory Requirements

Our Board of Directors establishes a formal capital adequacy plan that addresses capital goals in relation to risks. The capital adequacy plan assesses the capital level necessary for financial viability and to provide for growth. Our plan is updated annually and approved by our Board of Directors. FCA regulations require the plan consider the following factors in determining optimal capital levels:

- Regulatory capital requirements;
- Asset quality;
- Needs of our customer base; and
- Other risk-oriented activities, such as funding and interest rate risks, contingent and off-balance sheet liabilities and other conditions warranting additional capital.

FCA regulations establish minimum capital standards expressed as a ratio of capital to assets, taking into account relative risk factors for all System institutions. In general, the regulations provide for a relative risk weighting of assets and establish a minimum ratio of permanent capital, total surplus and core surplus to risk-weighted assets.

Our capital ratios as of December 31 and the FCA minimum requirements follow.

| | Regulatory Minimum | 2008 | 2007 | 2006 |
|-------------------------|--------------------|---------------|--------|--------|
| Permanent capital ratio | 7.00% | 18.95% | 23.14% | 25.01% |
| Total surplus ratio | 7.00% | 18.56% | 22.64% | 24.43% |
| Core surplus ratio | 3.50% | 18.56% | 21.72% | 23.83% |

As of December 31, 2008, we exceeded the regulatory minimum capital ratios and are expected to do so throughout 2009. However, the minimum ratios established were not meant to be adopted as the optimum capital level, so we have established goals in excess of the regulatory minimum. As of December 31, 2008, we have met our goals. Due to our strong capital position, we will continue to be able to retire at-risk stock.

During March 2007, AgBank issued preferred stock and reduced our required investment in AgBank from 6.25% to 5.00% effective April 2007. The Association did not receive a cash redemption for this transaction; however, the then excess investment in AgBank was transferred from required investment to excess investment, both of which are included in Investment in AgBank on the Consolidated Statement of Condition.

We have transferred \$1,500 of our excess investment in AgBank to AgBank's Excess Investment Priority Patronage Program. Under the terms of this program, the amount designated by an association is leveraged by AgBank in loans or investment securities for a term of up to two years. During that time, AgBank will count the designated amount as permanent capital and pay us an additional 50 basis points on the designated amount. Generally, we include our excess investment in AgBank as permanent capital, but exclude amounts transferred to this program from our permanent capital. At the conclusion of the capital counting term, September 9, 2010, the investment reverts back to us and may be included in our permanent capital once again. Our 2008 permanent capital ratio was decreased 0.45% due to this capital counting agreement.

REGULATORY MATTERS

As of December 31, 2008, we had no enforcement actions in effect and FCA took no enforcement actions on us during the year.

In November 2006, the FCA Board approved a rule that amends existing regulations relating to our disclosure and reporting requirements. The final rule includes revisions that, among other things:

- require Associations with total assets over \$1 billion to include an assessment of their internal control over financial reporting in their annual reports;
- reduce reporting filing deadlines with the FCA to 40 calendar days for our quarterly reports and 75 calendar days for our annual reports; and,
- revise regulations with respect to auditor independence and rotation, non-audit services and fees paid to the independent auditors.

The filing deadline changes were effective with the year-end 2007 annual report. On July 12, 2007, the FCA Board adopted a proposed rule that allows System institutions 90 days after the end of the year to prepare and distribute paper copies of their annual reports to shareholders. Each institution is required to file electronic copies of the report with FCA and post the report to its website within 75 days. The assessment of internal control over financial reporting was effective January 1, 2008 with the first disclosure in the 2008 annual report.

GOVERNANCE

Board of Directors

We are governed by a nine member board that oversees the management of our Association. Of these directors, eight are elected by the shareholders and one is appointed by the elected directors. The Board of Directors represents the interests of our shareholders. The Board of Directors meets regularly to perform the following functions, among others:

- selects, evaluates and compensates the chief executive officer;
- establishes the strategic plan and approves the annual operating plan and budget;
- oversees the lending operations;
- advises and counsels management on significant issues we face; and,
- oversees the financial reporting process, communications with shareholders and our legal and regulatory compliance.

Director Independence

All directors must exercise sound judgment in deciding matters in our interest. All our directors are independent from the perspective that none of our management or staff serves as Board members. However, we are a financial service cooperative, and the Farm Credit Act and FCA Regulations require our elected directors to have a loan relationship with us.

The elected directors, as borrowers, have a vested interest in ensuring our Association remains strong and successful. However, our borrowing relationship could be viewed as having the potential to compromise the independence of an elected director. For this reason, the Board has established independence criteria to ensure that a loan relationship does not compromise the independence of our Board. Annually, in conjunction with our independence analysis and reporting on our loans to directors, each director provides financial information and any other documentation and/or assertions needed for the Board to determine the independence of each Board member.

Audit Committee

The Audit Committee is responsible for assisting the Board. The Committee is composed of 5 members. During 2008, five meetings were held. The Audit Committee responsibilities include, but are not limited to:

- oversight of the financial reporting risk and the accuracy of the quarterly and annual shareholder reports;
- the oversight of the system of internal controls related to the preparation of quarterly and annual shareholder reports;
- the review and assessment of the impact of accounting and auditing developments on the consolidated financial statements; and,
- the establishment and maintenance of procedures for the receipt, retention and treatment of confidential and anonymous submission of concerns regarding accounting, internal accounting controls and auditing matters.

Compensation Committee

The Compensation Committee is responsible for the oversight of employee and director compensation. The Committee is composed of the full Board. The Committee annually reviews and evaluates all aspects of compensation, including benefits programs.

Other Governance

The Board has monitored the requirements of public companies under the Sarbanes-Oxley Act. While we are not subject to the requirements of this law, we are striving to implement steps to strengthen governance and financial reporting. We strive to maintain strong governance and financial reporting through the following actions:

- a system for the receipt and treatment of whistleblower complaints,
- a code of ethics for our President/CEO, Chief Financial Officer and Chief Credit Officer,
- open lines of communication between the independent auditors, management, and the Audit Committee,
- "plain English" disclosures,
- officer certification of accuracy and completeness of the consolidated financial statements, and,
- information disclosure through our website.

FORWARD-LOOKING INFORMATION

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

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

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our consolidated financial statements are based on accounting principles generally accepted in the United States of America. Our significant accounting policies are critical to the understanding of our results of operations and financial position because some accounting policies require us to make complex or subjective judgments and estimates that may affect the value of certain assets or liabilities. We consider these policies critical because we have to make judgments about matters that are inherently uncertain. For a complete discussion of significant accounting policies, see Note 2 of the accompanying consolidated financial statements. The following is a summary of certain critical policies.

Allowance for Loan Losses

The allowance for loan losses is our best estimate of the amount of probable losses existing in and inherent in our loan portfolio as of the balance sheet date. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through loan loss reversals and loan charge-offs. We determine the allowance for loan losses based on a regular evaluation of the loan portfolio, which generally considers recent historic charge-off experience adjusted for relevant factors.

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

Changes in the factors we consider in the evaluation of losses in the loan portfolios could occur for various credit related reasons and could result in a change in the allowance for loan losses, which would have a direct impact on the provision for loan losses and results of operations. See Note 2 and 3 to the accompanying consolidated financial statements for detailed information regarding the allowance for loan losses.

CUSTOMER PRIVACY

FCA regulations require that borrower information be held in confidence by Farm Credit institutions, their directors, officers and employees. FCA regulations specifically restrict Farm Credit institution directors and employees from disclosing information not normally contained in published reports or press releases about the institution or its borrowers or members. These regulations also provide Farm Credit institutions clear guidelines for protecting their borrowers' nonpublic information.

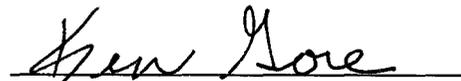
REPORT OF MANAGEMENT

The financial statements of the Farm Credit of Western Oklahoma, ACA are prepared by management, who is responsible for their integrity and objectivity, including amounts that must necessarily be based on judgments and estimates. The financial statements have been prepared in conformity with generally accepted accounting principles appropriate in the circumstances. The financial statements, in the opinion of management, fairly present the financial condition of the Association. Other financial information included in the annual report is consistent with that in the financial statements.

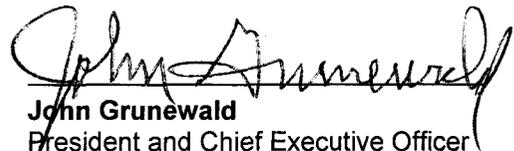
To meet the responsibility for reliable financial information, management depends on the Association's accounting and internal control systems which have been designed to provide reasonable, but not absolute, assurance assets are safeguarded and transactions are properly authorized and recorded. To monitor compliance, U.S. AgBank, FCB's Risk Management staff performs audits of the accounting records, reviews accounting systems and internal controls, and recommends improvements as appropriate. The financial statements are examined by PricewaterhouseCoopers LLP, independent auditors, who also conduct a review of internal controls to the extent necessary to comply with generally accepted auditing standards. The Association is also examined by the Farm Credit Administration.

The Audit Committee of the Board of Directors has overall responsibility for the Association's system of internal control and financial reporting. The Audit Committee consults regularly with management and reviews the results of the examinations by the various entities named above. The independent auditors have direct access to the Audit Committee.

The undersigned certify the Farm Credit of Western Oklahoma, ACA Annual Report has been reviewed, 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.



Ken Gore
Chairman of the Board



John Grunewald
President and Chief Executive Officer



Jamie Shirkey
Chief Financial Officer

February 27, 2009

AUDIT COMMITTEE REPORT

The Audit Committee (Committee) is comprised of five Directors of Farm Credit of Western Oklahoma, ACA (the Association) Board of Directors. In 2008, five Committee meetings were held. The Committee oversees the scope of the Association's internal audit program, the independence of the outside auditors, the adequacy of the Association's system of internal controls and procedures, and the adequacy of management's action with respect to recommendations arising from those auditing activities. The Committee's responsibilities are described more fully in the Internal Control Policy and the Audit Committee Charter. The Committee approved the appointment of PricewaterhouseCoopers, LLP (PwC) as the Association's independent auditors for 2008.

The fees for professional services rendered for the Association by its independent auditor, PwC, during 2008 were \$16,335 for audit services and \$5,600 for tax services.

The Committee reviewed the non-audit services provided by PwC and concluded these services were not incompatible with maintaining the independent auditor's independence.

Management is responsible for the Association's internal controls and the preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. PwC is responsible for performing an independent audit of the Association's consolidated financial statements in accordance with auditing standards generally accepted in the United States of America and to issue a report thereon. The Committee's responsibilities include monitoring and overseeing these processes.

In this context, the Committee reviewed and discussed the Association's Quarterly Reports and the Association's audited financial statements for the year ended December 31, 2008 (the "Audited Financial Statements") with management. The Committee also reviews with PwC the matters required to be discussed by Statement on Auditing Standards No. 114 (The Auditor's Communication with Those Charged with Governance). Both PwC and the Association's internal auditors directly provide reports on significant matters to the Committee.

Based on the foregoing review and discussions and relying thereon, the Committee recommended that the Board of Directors include the Audited Financial Statements in the Association's Annual Report to Shareholders for the year ended December 31, 2008.


Lavern W. Phillips, Chairman of the Audit Committee

Audit Committee Members

Jimmie Purvine
Clint Roush
Ronald White

Ken Gore, Chairman of the Board of Directors

February 27, 2009

Consolidated Statement of Condition

(Dollars in Thousands)

| | December 31 | | |
|----------------------------------------------------|--------------------|------------|------------|
| | 2008 | 2007 | 2006 |
| ASSETS | | | |
| Loans | \$ 322,796 | \$ 254,541 | \$ 215,364 |
| Less allowance for loan losses | 2,069 | 1,523 | 1,620 |
| Net loans | 320,727 | 253,018 | 213,744 |
| Cash | 5,635 | 4,788 | 3,967 |
| Accrued interest receivable | 4,596 | 4,575 | 4,828 |
| Investment in U.S. AgBank, FCB | 7,805 | 7,410 | 7,410 |
| Premises and equipment, net | 1,963 | 1,994 | 2,099 |
| Prepaid benefit expense | 630 | 518 | 744 |
| Deferred tax asset | 54 | 72 | 81 |
| Other assets | 203 | 207 | 192 |
| Total assets | \$ 341,613 | \$ 272,582 | \$ 233,065 |
| LIABILITIES | | | |
| Note payable to U.S. AgBank, FCB | \$ 265,083 | \$ 197,853 | \$ 161,733 |
| Advance conditional payments | 2,797 | 2,907 | 2,281 |
| Accrued interest payable | 4,705 | 6,241 | 5,357 |
| Patronage distributions payable | 2,000 | 2,003 | 1,957 |
| Accrued liability benefits | 179 | 239 | 409 |
| Other liabilities | 775 | 656 | 635 |
| Total liabilities | 275,539 | 209,899 | 172,372 |
| Commitments and Contingencies (See Note 13) | | | |
| SHAREHOLDERS' EQUITY | | | |
| Protected borrower stock | 10 | 29 | 37 |
| Capital stock | 1,265 | 1,286 | 1,282 |
| Unallocated retained earnings | 64,799 | 61,368 | 59,374 |
| Total shareholders' equity | 66,074 | 62,683 | 60,693 |
| Total liabilities and shareholders' equity | \$ 341,613 | \$ 272,582 | \$ 233,065 |

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

Consolidated Statement of Income

(Dollars in Thousands)

| | For the Year Ended December 31 | | |
|----------------------------------------------|---------------------------------------|-------------|-------------|
| | 2008 | 2007 | 2006 |
| INTEREST INCOME | | | |
| Loans | \$ 18,075 | \$ 16,777 | \$ 15,407 |
| Total interest income | 18,075 | 16,777 | 15,407 |
| INTEREST EXPENSE | | | |
| Note payable to U.S. AgBank, FCB | 9,376 | 9,755 | 8,383 |
| Other | 92 | 87 | 72 |
| Total interest expense | 9,468 | 9,842 | 8,455 |
| Net interest income | 8,607 | 6,935 | 6,952 |
| Loan loss reversal | (1,071) | (162) | (29) |
| Net interest income after loan loss reversal | 9,678 | 7,097 | 6,981 |
| NONINTEREST INCOME | | | |
| Financially related services income | 299 | 248 | 146 |
| Loan fees | 62 | 37 | 11 |
| Patronage distribution from U.S. AgBank, FCB | 1,268 | 1,481 | 1,440 |
| Other noninterest income | 88 | 73 | 74 |
| Total noninterest income | 1,717 | 1,839 | 1,671 |
| NONINTEREST EXPENSE | | | |
| Salaries and employee benefits | 2,883 | 2,356 | 2,404 |
| Occupancy and equipment | 417 | 397 | 322 |
| Purchased services from AgVantis, Inc. | 324 | 288 | 291 |
| Farm Credit Insurance Fund premium | 419 | 338 | 304 |
| Supervisory and examination costs | 93 | 91 | 93 |
| Other noninterest expense | 1,807 | 1,460 | 1,323 |
| Total noninterest expense | 5,943 | 4,930 | 4,737 |
| Income before income taxes | 5,452 | 4,006 | 3,915 |
| Provision for/(Benefit from) income taxes | 21 | 13 | (18) |
| Net income | \$ 5,431 | \$ 3,993 | \$ 3,933 |

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

Consolidated Statement of Changes in Shareholders' Equity

(Dollars in Thousands)

| | Protected Borrower Stock | Capital Stock | Unallocated Retained Earnings | Total Shareholders' Equity |
|-------------------------------------|--------------------------------|------------------|-------------------------------------|----------------------------------|
| Balance at December 31, 2005 | \$ 55 | \$ 1,315 | \$ 57,398 | \$ 58,768 |
| Net income | | | 3,933 | 3,933 |
| Stock issued | - | 204 | | 204 |
| Stock retired | (18) | (237) | | (255) |
| Patronage distributions: Cash | | | (1,957) | (1,957) |
| Balance at December 31, 2006 | 37 | 1,282 | 59,374 | 60,693 |
| Net income | | | 3,993 | 3,993 |
| Stock converted | (5) | 5 | | - |
| Stock issued | - | 205 | | 205 |
| Stock retired | (3) | (206) | | (209) |
| Patronage distributions: | | | | |
| Cash | | | (2,003) | (2,003) |
| Other | | | 4 | 4 |
| Balance at December 31, 2007 | 29 | 1,286 | 61,368 | 62,683 |
| Net income | | | 5,431 | 5,431 |
| Stock issued | - | 147 | | 147 |
| Stock retired | (19) | (168) | | (187) |
| Patronage distributions: Cash | | | (2,000) | (2,000) |
| Balance at December 31, 2008 | \$ 10 | \$ 1,265 | \$ 64,799 | \$ 66,074 |

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

Consolidated Statement of Cash Flows

(Dollars in Thousands)

| | For the Year Ended December 31 | | |
|---------------------------------------------------------------------------------------------|--------------------------------|----------|----------|
| | 2008 | 2007 | 2006 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Net income | \$ 5,431 | \$ 3,993 | \$ 3,933 |
| Adjustments to reconcile net income to net cash provided by/(used in) operating activities: | | | |
| Depreciation | 257 | 246 | 231 |
| Loan loss reversal | (1,071) | (162) | (29) |
| Patronage stock from U.S. AgBank, FCB | - | - | (337) |
| Gains on sales of premises and equipment | (18) | (8) | (20) |
| Change in assets and liabilities: | | | |
| Decrease/(Increase) in deferred tax asset | 18 | 9 | (21) |
| (Increase)/Decrease in accrued interest receivable | (21) | 253 | (1,130) |
| (Increase)/Decrease in prepaid benefit expense | (112) | 226 | 70 |
| Decrease/(Increase) in other assets | 4 | (15) | (3) |
| (Decrease)/Increase in accrued interest payable | (1,536) | 884 | 1,656 |
| (Decrease)/Increase in accrued liability benefits | (60) | (170) | 12 |
| Increase in other liabilities | 119 | 21 | 142 |
| Total adjustments | (2,420) | 1,284 | 571 |
| Net cash provided by operating activities | 3,011 | 5,277 | 4,504 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| Increase in loans, net | (66,638) | (39,112) | (6,335) |
| Increase in investment in U.S. AgBank, FCB | (395) | - | - |
| Expenditures for premises and equipment, net | (208) | (133) | (197) |
| Net cash used in investing activities | (67,241) | (39,245) | (6,532) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | | |
| Net draw on note payable to U.S. AgBank, FCB | 67,230 | 36,120 | 4,709 |
| (Decrease)/Increase in advance conditional payments | (110) | 626 | 756 |
| Protected borrower stock retired | (19) | (3) | (18) |
| Capital stock retired | (168) | (206) | (237) |
| Capital stock issued | 147 | 205 | 204 |
| Cash patronage distributions paid | (2,003) | (1,953) | (1,500) |
| Net cash provided by financing activities | 65,077 | 34,789 | 3,914 |
| Net increase in cash | 847 | 821 | 1,886 |
| Cash at beginning of year | 4,788 | 3,967 | 2,081 |
| Cash at end of year | \$ 5,635 | \$ 4,788 | \$ 3,967 |
| SUPPLEMENTAL CASH INFORMATION: | | | |
| Cash paid during the year for: | | | |
| Interest | \$ 11,004 | \$ 8,958 | \$ 6,799 |
| Income taxes | \$ 2 | \$ 7 | \$ 3 |
| SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES: | | | |
| Protected borrower stock converted to capital stock | \$ - | \$ 5 | \$ - |
| Net recoveries | \$ (1,617) | \$ (65) | \$ (28) |
| Patronage distributions payable | \$ 2,000 | \$ 2,003 | \$ 1,957 |

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in Thousands, Except as Noted)

NOTE 1 – ORGANIZATION AND OPERATIONS

- A. Organization: Farm Credit of Western Oklahoma, ACA and its subsidiaries, Farm Credit of Western Oklahoma, FLCA, (Federal Land Credit Association) (FLCA)) and Farm Credit of Western Oklahoma, PCA, (Production Credit Association (PCA)), (collectively called “the Association”) are member-owned cooperatives which provide credit and credit-related services to or for the benefit of eligible borrowers/shareholders for qualified agricultural purposes in the counties of Beaver, Beckham, Cimarron, Custer, Dewey, Ellis, Harper, Roger Mills, Texas, Washita, Woods and Woodward in the state of Oklahoma.

The Association is a lending institution of the Farm Credit System (System), a nationwide system of cooperatively owned banks and associations, which was established by Acts of Congress to meet the credit needs of American agriculture and is subject to the provisions of the Farm Credit Act of 1971, as amended (the Farm Credit Act). The most recent significant amendment of the Farm Credit Act was the Agricultural Credit Act of 1987. At December 31, 2008, the System was comprised of four Farm Credit Banks, one Agricultural Credit Bank and more than 90 associations.

U.S. AgBank, FCB (AgBank), its related associations and AgVantis, Inc. (AgVantis) are collectively referred to as the District. AgBank provides the majority of funding to associations within the District and is responsible for supervising certain activities of the District Associations. AgVantis, which is owned by the entities it serves, provides technology and other operational services to AgBank and certain associations. On December 31, 2008, the District consisted of AgBank, 25 Agricultural Credit Association (ACA) parent companies, which each have two wholly owned subsidiaries, (a FLCA and a PCA), two FLCAs and AgVantis.

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

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

The Farm Credit Act established the Farm Credit System Insurance Corporation (Insurance Corporation) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is required to be used (1) to ensure the timely payment of principal and interest on Systemwide debt obligations, (2) to ensure the retirement of protected stock at par or stated value, and (3) for other specified purposes. The Insurance Fund is also available for discretionary use by the Insurance Corporation in providing assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation. Each System Bank has been 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 two percent of the aggregate insured obligations (Systemwide debt obligations) or such other percentage of the aggregate obligations as the Insurance Corporation in its sole discretion determines is actuarially sound. When the amount in the Insurance Fund exceeds the secure base amount, the Insurance Corporation is required to reduce premiums, but it still must ensure that reduced premiums are sufficient to maintain the level of the Insurance Fund at the secure base amount. In June 2008, with the passage of the Food, Conservation, and Energy Act of 2008 (Farm Bill), the basis for assessing premiums was changed, beginning with the second half of 2008, to reflect each System Bank’s pro rata share of outstanding insured debt from the prior basis of loans. The Farm Bill imposes premiums of up to 20 basis points on adjusted insured debt obligations with the Insurance Corporation Board having the ability to reduce the amount, and a risk surcharge of 10 basis points on nonaccrual loans and other-than-temporarily impaired investments. AgBank passes this premium expense through to the Association based on the Association’s average adjusted note payable with AgBank.

- 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 also serves as an intermediary in offering credit life insurance, livestock risk insurance, multi-peril crop and crop hail insurance, and providing additional services to borrowers such as appraisals and an investment bond program.

The Association's financial condition may be impacted by factors affecting AgBank. Certain District expenses are allocated to the associations. Disclosure of certain accounting policies related to these costs is included in the U.S. AgBank District Annual Report to Shareholders (District's Annual Report). The District's Annual Report is available on its website, www.usagbank.com; or upon request. Association shareholders will be provided with a copy of the District's Annual Report, which includes the combined financial statements of AgBank and its related associations, and AgVantis, upon request. The District's Annual Report discusses the material aspects of the District's financial condition, changes in financial condition, and results of operations. In addition, the District's Annual Report identifies favorable and unfavorable trends, significant events, uncertainties and the impact of activities by the Insurance Corporation.

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

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' consolidated financial statements have been reclassified to conform to current financial statement presentation. Human resource services previously provided by AgBank are now provided by Farm Credit Foundations. These services are reflected in other noninterest expense.

The consolidated financial statements include the accounts of Farm Credit of Western Oklahoma, FLCA and Farm Credit of Western Oklahoma, PCA. All significant inter-company transactions have been eliminated in consolidation.

- A. Loans and Allowance for Loan Losses: Long-term real estate mortgage loans generally have original maturities ranging from five to 40 years. Substantially all short- and intermediate-term loans made for agricultural production or operating purposes have maturities of ten years or less. Loans are carried at their principal amount outstanding adjusted for charge-offs and deferred loan fees or costs. Interest on loans is accrued and credited to interest income based upon the daily principal amount outstanding.

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

Impaired loans are loans for which it is probable that not all principal and interest will be collected according to the contractual terms of the loan. Impaired loans include nonaccrual loans, restructured loans, and loans past due 90 days or more and still accruing interest. A loan is considered contractually past due when any principal repayment or interest payment required by the loan instrument is not received on or before the due date. A loan shall remain contractually past due until it is formally restructured or until the entire amount past due, including principal, accrued interest, and penalty interest incurred as the result of past due status, is collected or otherwise discharged in full.

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

When loans are in nonaccrual status, loan payments are generally applied against the recorded investment in the loan asset. Nonaccrual loans may, at times, be maintained on a cash basis. Generally, cash basis refers to the recognition of interest income from cash payments received on certain nonaccrual loans for which the collectibility of the recorded investment in the loan is no longer in doubt and the loan does not have a remaining unrecovered charge-off associated with it. Nonaccrual loans may be returned to accrual status when all contractual principal and interest payments are current, prior charge-offs have been recovered, the ability of the borrower to fulfill the contractual repayment terms is fully expected and the loan is not classified Doubtful or Loss. Loans are charged-off, wholly or partially, as appropriate, at the time they are determined to be uncollectible.

The allowance for loan losses is maintained at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio. The allowance is 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.

- B. Cash: Cash, as included in the consolidated financial statements, represents cash on hand and on deposit at banks.
- C. Investment in AgBank: The Association's investment in AgBank is in the form of Class A Stock. The minimum required investment in AgBank is 5.00 percent of average direct loan volume, net of excess investment. During March 2007, AgBank issued preferred stock and reduced the Association's required investment in AgBank from 6.25 percent to 5.00 percent effective April 2007. The Association did not receive a cash redemption for this transaction; however, the then excess investment in AgBank was transferred from required investment to excess investment, both of which are included in Investment in AgBank on the Consolidated Statement of Condition. The required investment will be adjusted on a quarterly basis to reflect changes in direct loan volume. The required investment may consist of AgBank surplus attributed to the Association, patronage based stock and purchased stock.
- D. Premises and Equipment: Land is carried at cost. 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.
- E. Other Assets and Other Liabilities: Other assets are comprised primarily of accounts receivable, prepaid expenses, and investment in Farm Credit institutions. Significant components of other liabilities primarily include accounts payable.
- F. Advance Conditional Payments: The Association is authorized under the Farm Credit Act to accept advance payments from borrowers. Amounts received on short- and intermediate-term loans are recorded in the Consolidated Statement of Condition as liabilities and represent borrower payments in excess of the related loan balance or amounts to which the borrower has unrestricted access. A limited amount of funds, reserved for future loan repayments and placed in trust fund accounts, is permitted on long-term loans. These amounts are netted against loans on the Consolidated Statement of Condition. Advance conditional payments are not insured. Interest is generally paid by the Association on advance conditional payments.
- G. Employee benefit plans: Substantially all employees of the Association participate in the Ninth Farm Credit District Pension Plan (Pension Plan) and/or the Farm Credit Foundations Defined Contribution/401(k) Plan (401(k) Plan). The Pension Plan is a non-contributory defined benefit plan. Benefits are based on compensation and years of service. The Association recognizes its proportional share of expense and contributes its proportional share of funding. Detailed financial information for the Pension Plan may be found in the District's Annual Report. The Pension Plan was closed to new participants beginning January 1, 2007, amended and then terminated during 2007 for those participants with benefits only in the Account Balance Provisions of the Pension Plan. The accrued benefits for these participants were distributed from the Pension Plan and were transferred to the 401(k) Plan. The Association matches a certain percentage of employee contributions to the 401(k) Plan. The 401(k) Plan costs are expensed monthly as funded.

The Association also participates in the Farm Credit Foundations Retiree Medical Plan. These postretirement benefits (other than pensions) are provided to eligible retired employees of the Association. Prior to 2007, only employees who were hired before 2004 could become eligible for employer subsidies under the Retiree Medical Plan. These benefits and the anticipated costs of these benefits were accrued during the period of the employee's active service. During 2007, the Retiree Medical Plan was amended to only continue employer subsidized benefits for current retirees. Accrued balances as of September 30, 2007 for eligible employees were converted to present value and transferred to the Pension Plan as an additional pension benefit.

- H. Income Taxes: As previously described, the ACA holding company conducts its business activities through two wholly owned subsidiaries. Long-term mortgage lending activities are operated through a wholly owned FLCA subsidiary which is exempt from federal and state income tax. Short- and intermediate-term lending activities are operated through a wholly owned PCA subsidiary. Operating expenses are allocated to each subsidiary based on estimated relative service. All significant transactions between the subsidiaries and the

parent company have been eliminated in consolidation. The ACA, along with the PCA subsidiary, is subject to income taxes. The Association accounts for income taxes under the liability method. Accordingly, deferred taxes are recognized for estimated taxes ultimately payable or recoverable based on federal, state or local laws.

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 earnings that will not be distributed as qualified patronage refunds. Deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the carrying amounts reflected in the consolidated financial statements and tax bases of assets and liabilities. In addition, a valuation allowance is provided against deferred tax assets to the extent that it is more likely than not (over 50 percent probability), based on management's estimate, that the deferred tax assets will not be realized. The consideration of valuation allowances involves various estimates and assumptions as to future taxable earnings, including the effects of the Association's expected patronage program, which reduces taxable earnings.

Deferred income taxes have not been provided by the Association on patronage stock distributions received from AgBank prior to January 1, 1993, the adoption date of SFAS No. 109. Management's intent is 1) to permanently invest these and other undistributed earnings in AgBank, thereby indefinitely postponing their conversion to cash, or 2) to pass through any distribution related to pre-1993 earnings to Association borrowers through qualified patronage allocations.

The Association has not provided deferred income taxes on amounts allocated to the Association which relate to AgBank's post-1992 earnings to the extent that such earnings will be passed through to Association borrowers through qualified patronage allocations. Additionally, deferred income taxes have not been provided on AgBank's post-1992 unallocated earnings. AgBank currently has no plans to distribute unallocated AgBank earnings and does not contemplate circumstances that, if distributions were made, would result in taxes being paid at the Association level.

- I. Patronage Distribution from AgBank: Patronage distributions are made by AgBank the month following quarter-end. The Association records patronage distributions from AgBank upon receipt of the distribution.
- J. Fair Value Measurement: Effective January 1, 2008, the Association adopted Statement Financial Accounting Standard No. 157, "Fair Value Measurements" (SFAS No. 157). This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. The Association did not have any significant assets or liabilities on the Consolidated Statement of Condition measured at fair value requiring expanded disclosures.

NOTE 3 – LOANS AND ALLOWANCE FOR LOAN LOSSES

A summary of loans follows.

| | December 31 | | |
|----------------------------------|--------------------|------------|------------|
| | 2008 | 2007 | 2006 |
| Real estate mortgage | \$ 196,023 | \$ 163,534 | \$ 149,293 |
| Production and intermediate-term | 121,036 | 87,870 | 63,088 |
| Agribusiness: | | | |
| Loans to cooperatives | 1,395 | – | – |
| Processing and marketing | 2,145 | 1 | – |
| Farm related business | 750 | 1,144 | 877 |
| Rural residential real estate | 1,447 | 1,992 | 2,106 |
| Total | \$ 322,796 | \$ 254,541 | \$ 215,364 |

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.

| Commodity | December 31 | | | | | |
|-----------------------------------|-------------------|----------------|-------------------|----------------|-------------------|----------------|
| | 2008 | | 2007 | | 2006 | |
| | Amount | Percent | Amount | Percent | Amount | Percent |
| Beef | \$ 201,618 | 62.46% | \$ 121,186 | 47.61% | \$ 93,834 | 43.57% |
| Wheat | 37,993 | 11.77% | 30,494 | 11.98% | 31,357 | 14.56% |
| Cash Grain/Corn/Sorghum | 37,606 | 11.65% | 26,116 | 10.26% | 21,666 | 10.06% |
| Peanuts/Cotton/Peppers/Watermelon | 6,069 | 1.88% | 7,509 | 2.95% | 9,239 | 4.29% |
| Dairy | 6,004 | 1.86% | 815 | 0.32% | 883 | 0.41% |
| Landlords | 5,068 | 1.57% | 2,011 | 0.79% | 2,024 | 0.94% |
| Hay | 4,713 | 1.46% | 1,833 | 0.72% | 1,421 | 0.66% |
| Poultry | 4,487 | 1.39% | 1,324 | 0.52% | — | — |
| Hogs | 3,906 | 1.21% | 4,073 | 1.60% | 4,286 | 1.99% |
| Other | 15,332 | 4.75% | 59,180 | 23.25% | 50,654 | 23.52% |
| Total | \$ 322,796 | 100.00% | \$ 254,541 | 100.00% | \$ 215,364 | 100.00% |

In previous periods, loans to rural residents and part-time farmers were reported in the group "Other" but have been re-categorized based on the primary agriculture product produced.

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 first liens on the underlying real property. Federal regulations state that long-term real estate loans are not to exceed 85 percent (97 percent if guaranteed by a government agency) of the property's appraised value. However, a decline in a property's market value subsequent to loan origination or advances, or other actions necessary to protect the financial interest of the Association in the collateral, may result in loan to value ratios in excess of the regulatory maximum.

Impaired loans are loans for which it is probable that all principal and interest will not be collected according to the contractual terms. The following presents information relating to impaired loans including accrued interest.

| | December 31 | | |
|--------------------------------------|-----------------|-----------------|-----------------|
| | 2008 | 2007 | 2006 |
| Nonaccrual: | | | |
| Current as to principal and interest | \$ 5,408 | \$ 3,303 | \$ 1,264 |
| Past due | — | 442 | 87 |
| Total nonaccrual loans | 5,408 | 3,745 | 1,351 |
| Impaired accrual loans: | | | |
| Restructured accrual loans | 189 | 392 | 546 |
| Total impaired loans | \$ 5,597 | \$ 4,137 | \$ 1,897 |

There were no loans classified accruing loans 90 days or more past due for the years presented.

There were no material commitments to lend additional funds to debtors whose loans were classified impaired at December 31, 2008.

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 and average impaired loans.

| | Year Ended December 31 | | |
|-----------------------------------------------------|------------------------|---------------|---------------|
| | 2008 | 2007 | 2006 |
| Interest income recognized on nonaccrual loans | \$ 662 | \$ 82 | \$ 92 |
| Interest income on impaired accrual loans | 101 | 147 | 138 |
| Interest income recognized on impaired loans | \$ 763 | \$ 229 | \$ 230 |
| Average impaired loans | \$ 3,231 | \$ 4,221 | \$ 2,069 |

The following table presents information concerning impaired loans.

| | December 31 | | |
|------------------------------------------|--------------------|----------|----------|
| | 2008 | 2007 | 2006 |
| Impaired loans with related allowance | \$ – | \$ 561 | \$ 81 |
| Impaired loans with no related allowance | 5,597 | 3,576 | 1,816 |
| Total impaired loans | \$ 5,597 | \$ 4,137 | \$ 1,897 |
| Allowance on impaired loans | \$ – | \$ 111 | \$ 9 |

Interest income on nonaccrual and accruing restructured loans that would have been recognized under the original terms of the loans follows.

| | Year Ended December 31 | | |
|--------------------------------------------------------------------------------|-------------------------------|--------|--------|
| | 2008 | 2007 | 2006 |
| Interest income which would have been recognized under the original loan terms | \$ 498 | \$ 565 | \$ 283 |
| Less: interest income recognized | 754 | 231 | 220 |
| Interest income (recognized)/not recognized | \$ (256) | \$ 334 | \$ 63 |

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

| | 2008 | 2007 | 2006 |
|-------------------------------------|-----------------|----------|----------|
| Balance at beginning of year | \$ 1,523 | \$ 1,620 | \$ 1,621 |
| Charge-offs: | | | |
| Production and intermediate-term | 14 | 16 | 21 |
| Recoveries: | | | |
| Production and intermediate-term | – | 81 | 19 |
| Agribusiness | 1,631 | – | 30 |
| Net recoveries | (1,617) | (65) | (28) |
| Loan loss reversal | (1,071) | (162) | (29) |
| Balance at December 31 | \$ 2,069 | \$ 1,523 | \$ 1,620 |
| Net recoveries to average net loans | (0.58%) | (0.03%) | (0.01%) |

A breakdown of the allowance for loan losses follows.

| | 2008 | | 2007 | | 2006 | |
|----------------------------------|-----------------|----------------|----------|---------|----------|---------|
| | Amount | Percent | Amount | Percent | Amount | Percent |
| Real estate mortgage | \$ 207 | 10.01% | \$ 338 | 22.19% | \$ 252 | 15.56% |
| Production and intermediate-term | 1,815 | 87.72% | 1,179 | 77.42% | 1,360 | 83.95% |
| Agribusiness | 46 | 2.22% | 4 | 0.26% | 1 | 0.06% |
| Rural residential real estate | 1 | 0.05% | 2 | 0.13% | 7 | 0.43% |
| Total | \$ 2,069 | 100.00% | \$ 1,523 | 100.00% | \$ 1,620 | 100.00% |

NOTE 4 – INVESTMENT IN AGBANK

The Association's investment in AgBank may consist of AgBank surplus attributed to the Association, patronage based stock and purchased stock. The Association's stock investment in AgBank is in the form of Class A Stock. The Association is required to maintain an investment in AgBank equal to 5.00 percent of average direct loan volume, net of excess investment. During March 2007, AgBank issued preferred stock and reduced the Association's required investment in AgBank from 6.25 percent to 5.00 percent effective April 2007. The Association did not receive a cash redemption for this transaction; however, the then excess investment in AgBank was transferred from required investment to excess investment, both of which are included in Investment in AgBank on the Consolidated Statement of Condition. The investment in AgBank will be adjusted on a quarterly basis to reflect changes in direct loan volume, attributed surplus and stock investment balances. If needed to meet capital adequacy requirements, AgBank may require the Association to purchase at-risk stock subject to a limit of one percent of the Association's average Direct Loan Volume in a twelve month period.

NOTE 5 – PREMISES AND EQUIPMENT

Premises and equipment consisted of the following.

| | 2008 | 2007 | 2006 |
|--------------------------------------|-----------------|----------|----------|
| Land | \$ 145 | \$ 145 | \$ 145 |
| Buildings and leasehold improvements | 2,428 | 2,428 | 2,315 |
| Furniture, equipment and automobiles | 1,371 | 1,231 | 1,156 |
| Construction in progress | – | – | 113 |
| | 3,944 | 3,804 | 3,729 |
| Less: accumulated depreciation | 1,981 | 1,810 | 1,630 |
| Total | \$ 1,963 | \$ 1,994 | \$ 2,099 |

NOTE 6 – NOTE PAYABLE TO AGBANK

The Association's indebtedness to AgBank 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 is governed by a General Financing Agreement (GFA) which provides for a \$275 million line of credit. The GFA and promissory note are subject to periodic renewals in the normal course of business. The Association was in compliance with the terms and conditions of the GFA as of December 31, 2008. Substantially all borrower loans are match-funded with AgBank. Payments and disbursements are made on the note payable to AgBank on the same basis the Association collects payments from and disburses on borrower loans. The interest rate may periodically be adjusted by AgBank based on the terms and conditions of the borrowing. The weighted average interest rate was 4.17 percent for the year ended December 31, 2008. The line of credit expires on April 30, 2009, however, the Association expects renewal of the line of credit. Upon expiration of the line of credit, undisbursed amounts available under the line of credit expire. So long as the Association is not in material default under the GFA, AgBank will continue to make advances (that do not exceed the amount payable under the promissory note) for undisbursed outstanding commitments on borrower loans which are not in default. The note payable to AgBank will continue until it has been fully discharged.

The Association has the opportunity to commit funds with AgBank in the Earnings Stabilization Management Program at a fixed rate for a specified timeframe. Participants in the program receive a fixed rate credit on the committed funds balance classified as a reduction of interest expense. These committed funds, which are netted against the note payable to AgBank, as of December 31, follow.

| | 2008 | 2007 | 2006 |
|-----------------|----------|----------|--------|
| Committed funds | \$ 1,000 | \$ 2,000 | \$ 700 |
| Average rates | 5.30% | 5.36% | 3.57% |

Under the Farm Credit Act, the Association is obligated to borrow only from AgBank, unless AgBank gives approval to borrow elsewhere. AgBank, 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, 2008, the Association's notes payable are within the specified limitations.

NOTE 7 – SHAREHOLDERS' EQUITY

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

A. Protected Borrower Stock

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

B. Capital Stock and Participation Certificates

In accordance with the Association's capitalization bylaws, each borrower is required to invest in the Association as a condition of borrowing. Capitalization bylaws allow stock requirements to range from the lesser of one thousand dollars or 2.00 percent of the amount of the loan to 10.00 percent of the loan. The Board of Directors has the authority to change the minimum required stock level of a shareholder as long as

the change is within this range. Currently, the Association has a stock requirement of the lesser of one thousand dollars or 2.00 percent of the borrower's combined loan volume.

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

C. Regulatory Capitalization Requirements and Restrictions

The FCA's capital adequacy regulations require the Association to maintain permanent capital of 7.00 percent of risk-adjusted assets and off-balance-sheet commitments. Failure to meet this 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 consolidated 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. The FCA regulations also require that additional minimum standards for capital be achieved. These standards require all System institutions to achieve and maintain ratios of total surplus as a percentage of risk-adjusted assets of 7.00 percent and of core surplus (generally unallocated surplus) as a percentage of risk-adjusted assets of 3.50 percent. At December 31, 2008, the Association's permanent capital was 18.95 percent, core surplus was 18.56 percent and total surplus ratio was 18.56 percent.

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 following paragraphs describe the attributes of each class of stock authorized by the Association bylaws and indicates the number of shares outstanding at December 31, 2007. Unless otherwise indicated all classes of stock have a par value of \$5.00.

Class A Common Stock (Nonvoting, at-risk, no shares outstanding) - Issued in exchange for Class B Common Stock or Class C Common Stock; as a patronage refund; as a dividend; or in exchange for allocated surplus. Retirement is at the sole discretion of the Board of Directors.

Class B Common Stock (Voting, at-risk, 248,720 shares outstanding) - Issued solely to, and shall be acquired by, borrowers and other applicants who are farmers, ranchers, or producers or harvesters of aquatic products and who are eligible to vote. Class B Common Stock may also be held by those borrowers who exchanged one share of Class F Common Stock for one share of Class B Common Stock. Each Class B Common shareholder shall hold at least one share as long as the holder continues business with the Association. Within two years after the holder terminates its relationship with the Association, any outstanding Class B Common Stock shall be converted to Class A Common Stock. Retirement is at the sole discretion of the Board of Directors.

Class C Common Stock (Nonvoting, at-risk, 4,254 shares outstanding) - Class C Common Stock may be issued to borrowers or applicants who are: (a) rural residents, including persons eligible to hold voting stock, to capitalize rural housing loans; (b) persons or organizations furnishing farm-related services; (c) other persons or organizations who are eligible to borrow from or participate with the Association but who are not eligible to hold voting stock. Class C Common Stock may be issued to any person who is not a shareholder but who is eligible to borrow from the Association for the purpose of qualifying such person for technical assistance, financially related services and leasing services offered by the Association. Within two years after the holder terminates its relationship with the Association, any outstanding Class C Common Stock shall be converted to Class A Common Stock. Retirement is at the sole discretion of the Board of Directors.

Class D Common Stock (Nonvoting, at-risk, no shares outstanding, par value of one thousand dollars) - Issued to AgBank or to any person through direct sale.

- Class E Preferred Stock (Nonvoting, at-risk, no shares outstanding, par value as may be determined by any agreement of financial assistance between the Association and AgBank) - Issued only to AgBank in consideration of financial assistance to the Association from AgBank. Retirement is at the sole discretion of the Board of Directors.
- Class F Common Stock (Voting, protected, 1,964 shares outstanding) - Shall be issued to those individuals and entities who held the same class of stock in a predecessor to the Association. The Association shall not issue any additional Class F Common Stock. Each Class F Common shareholder shall hold at least one share as long as the holder continues business with the Association. Within two years after the holder terminates its relationship with the Association, any outstanding Class F Common Stock shall be converted to Class G Common Stock. Retirement is at the sole discretion of the Board of Directors.
- Class G Common Stock (Nonvoting, protected, 61 shares outstanding) - Issued only to those individuals and entities who held the same class of stock in a predecessor to the Association and as necessary for conversions from Class F Common Stock. No further shares of Class G Common Stock will be issued. It must be retired upon repayment of the loan.

E. Patronage and/or Dividends

Dividends may be declared or patronage distributions allocated to holders of Class B, C, F and G Stock out of the whole or any part of net earnings which remain at the end of the fiscal year, as the Board of Directors may determine, in accordance with the regulations for banks and associations of the System. However, distributions and retirements are precluded by regulation until the minimum capital adequacy standards have been attained. Amounts not distributed are retained as unallocated retained earnings. The Association made a cash patronage distribution of \$2,003 in 2008, \$1,953 in 2007 and \$1,500 in 2006 and declared a \$2,000 patronage in 2008 to be distributed in 2009.

In the event of liquidation or dissolution of the Association, any assets of the Association remaining after payment or retirement of all liabilities shall be distributed to retire stock in the following order of priority: First, pro rata to all classes of preferred stock; second, pro rata to all classes of common stock; third, to the 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; fourth, to the holders of allocated surplus evidenced by non-qualified written notices of allocation, in the order of year of issuance and pro rata by year of issuance. Any remaining assets of the Association after such distributions shall be distributed to present and former Patrons on a patronage basis, to the extent practicable.

The Association allocated 36.87 percent of its patronage-sourced net income to its patrons. At each year end, the Board of Directors evaluates whether to retain the Association's net income to strengthen its capital position or to distribute a portion of the net income to customers by declaring a qualified/cash patronage refund.

NOTE 8 – PATRONAGE DISTRIBUTION FROM AGBANK

The patronage distribution from AgBank follows.

| | Year Ended December 31 | | |
|------------------------------------|------------------------|-----------------|-----------------|
| | 2008 | 2007 | 2006 |
| Cash patronage | \$ 1,268 | \$ 1,481 | \$ 1,103 |
| Stock allocation | - | - | 337 |
| Total patronage from AgBank | \$ 1,268 | \$ 1,481 | \$ 1,440 |

NOTE 9 – INCOME TAXES

The provision for/(benefit from) income taxes follows.

| | Year Ended December 31 | | |
|-------------------------------------------|------------------------|-------|---------|
| | 2008 | 2007 | 2006 |
| Current: | | | |
| Federal | \$ 1 | \$ 4 | \$ 4 |
| State | 1 | – | – |
| Deferred: | | | |
| Federal | 16 | 8 | (4) |
| State | 3 | 1 | (18) |
| Provision for/(Benefit from) income taxes | \$ 21 | \$ 13 | \$ (18) |

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

| | Year Ended December 31 | | |
|---------------------------------------------|------------------------|----------|----------|
| | 2008 | 2007 | 2006 |
| Federal tax at statutory rate | \$ 1,854 | \$ 1,361 | \$ 1,331 |
| State tax, net | 3 | 1 | (12) |
| Effect of non-taxable FLCA subsidiary | (1,664) | (1,249) | (1,400) |
| AgBank stock patronage dividend | – | – | (114) |
| Reduction in deferred tax asset - Patronage | 36 | 15 | (5) |
| Other | (208) | (115) | 182 |
| Provision for/(Benefit from) income taxes | \$ 21 | \$ 13 | \$ (18) |

Deferred tax assets and liabilities are comprised of the following.

| | December 31 | | |
|----------------------------------------|-------------|--------|--------|
| | 2008 | 2007 | 2006 |
| Allowance for loan losses | \$ 338 | \$ 370 | \$ 484 |
| Write down of other property | – | 31 | 31 |
| Nonaccrual loan interest | 33 | 101 | 38 |
| Excess book depreciation > Tax depr. | 34 | 33 | 31 |
| Charitable contribution carryover | 40 | 40 | 40 |
| State NOL carryover | 27 | 34 | 61 |
| Federal NOL carryover | 135 | 196 | 254 |
| Organizational costs | – | – | 2 |
| Gross deferred tax assets | 607 | 805 | 941 |
| Deferred tax asset valuation allowance | (530) | (711) | (838) |
| Sale of fixed assets | (3) | (4) | (4) |
| Depletion | (20) | (18) | (18) |
| Gross deferred tax liability | (23) | (22) | (22) |
| Net deferred tax asset | \$ 54 | \$ 72 | \$ 81 |

The calculation of tax assets and liabilities involves various management estimates and assumptions as to the future taxable earnings. The Association had a valuation allowance of \$530 during 2008, \$711 during 2007 and \$838 during 2006. The Association will continue to evaluate the likely realization of these deferred tax assets and adjust the valuation allowance accordingly.

The Association has no uncertain tax positions to be recognized as of December 31, 2008 or 2007. The tax years that remain open for federal and major state income tax jurisdictions are 2005 and forward.

NOTE 10 – EMPLOYEE BENEFIT PLANS

The employees of the Association may participate in the District's defined benefit pension plan (Pension Plan). The Pension Plan is noncontributory and covers a significant number of employees. Benefits are based on compensation and years of service. The Association recognizes its proportional share of expense and contributes its proportional

share of funding. As a participant in the District's defined benefit plan, the Association funded \$290 for 2008 and \$149 for 2006, through its note payable to AgBank. The Pension Plan required no funding during 2007. Pension Plan expenses included in salaries and employee benefits expense were \$178 for 2008, \$227 for 2007 and \$218 for 2006. As of January 1, 2007, the Pension Plan was closed to new participants. During 2007, those participants with benefits only in the Account Balance provisions of the Pension Plan were spun off into a separate pension plan, which was then terminated. The termination resulted in immediate expense recognition of \$53 by the Association for its proportional share which is included in the above Pension Plan expenses. Additional financial information for the Pension Plan may be found in the District's Annual Report.

Postretirement benefits other than pensions are provided through the Farm Credit Foundations Retiree Medical Plan to retired employees of the Association. Benefits provided are determined on a graduated scale, based on years of service. The anticipated costs of these benefits were accrued during the period of the employee's active service. Postretirement benefits (primarily health care benefits) included in salaries and employee benefits was expense of \$12 for 2008, income of \$130 for 2007 and expense of \$41 for 2006. During 2008, the life insurance benefit in the plan was funded by a one-time buy-out contribution with an insurance company resulting in income recognition of \$4 and additional cash contributions of \$30. Prior to 2007, only employees who were hired before 2004 could become eligible for employer subsidies under the Retiree Medical Plan. As of September 30, 2007, the Retiree Medical Plan was amended to only continue employer subsidized benefits for current retirees. Accrued balances as of September 30 for eligible employees were converted to present value and transferred to the Pension Plan as an additional pension benefit. This amendment and termination of benefits resulted in the immediate recognition of income of \$168 by the Association for its proportional share which is included in the above Postretirement benefits expense. Additional financial information for this plan may be found in the District's Annual Report.

The Association also participates in the Farm Credit Foundations Defined Contribution/401(k) Plan (Contribution Plan). The Association matches a certain percentage of employee contributions to the plan. Employer contributions to this plan were \$145, \$96 and \$75 for the years ended December 31, 2008, 2007 and 2006, respectively.

NOTE 11 – RELATED PARTY TRANSACTIONS

In the ordinary course of business, the Association may enter 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, amortization schedules and collateral, as those prevailing at the time for comparable transactions with unrelated borrowers.

The Association has a policy that loans to directors and senior officers must be maintained at an Acceptable or Other Assets Especially Mentioned (OAEM) credit classification. If the loan falls below the OAEM credit classification, corrective action must be taken and the loan brought back to either Acceptable or OAEM within a year. If not, the director or senior officer must resign from the Board or employment.

Loan information to related parties at December 31 is shown below.

| | 2008 | 2007 | 2006 |
|----------------|-----------|-----------|-----------|
| New loans | \$ 22,796 | \$ 11,722 | \$ 10,719 |
| Repayments | \$ 21,382 | \$ 10,565 | \$ 7,635 |
| Ending balance | \$ 10,637 | \$ 8,554 | \$ 7,111 |

In the opinion of management, none of these loans outstanding at December 31, 2008 involved more than a normal risk of collectibility.

The Association also has business relationships with certain other System entities. The Association paid \$324 to AgVantis for technology services during 2008.

NOTE 12 – REGULATORY ENFORCEMENT MATTERS

There are no regulatory enforcement actions in effect for the Association.

NOTE 13 – COMMITMENTS AND CONTINGENCIES

The Association has various commitments outstanding and contingent liabilities.

The Association may participate in financial instruments with off-balance sheet risk to satisfy the financing needs of its borrowers and to manage their exposure to interest-rate risk. These financial instruments include commitments to

extend commercial letters of credit. The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated 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. Standby 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 by the borrower. At December 31, 2008, \$78,697 of commitments to extend credit and \$62 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 Consolidated Statement of Condition until funded or drawn upon. The credit risk associated with issuing commitments 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.

With regard to contingent liabilities, there are no actions pending against the Association in which claims for monetary damages are asserted.

NOTE 14 – DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

The following table presents the carrying amounts and fair values of the Association's financial instruments at December 31, 2008, 2007 and 2006. The fair value of a financial instrument is the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability. Quoted market prices are generally not available for certain 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 follows.

| | December 31 | | | | | |
|------------------------------|-----------------|------------|-----------------|------------|-----------------|------------|
| | 2008 | | 2007 | | 2006 | |
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Financial assets: | | | | | | |
| Loans, net | \$ 320,727 | \$ 325,960 | \$ 253,018 | \$ 255,644 | \$ 213,745 | \$ 212,523 |
| Cash | \$ 5,635 | \$ 5,635 | \$ 4,788 | \$ 4,788 | \$ 3,967 | \$ 3,967 |
| Financial liabilities: | | | | | | |
| Note payable to AgBank | \$ 265,083 | \$ 270,574 | \$ 197,853 | \$ 200,775 | \$ 161,733 | \$ 160,481 |
| Advance conditional payments | \$ 2,797 | \$ 2,797 | \$ 2,907 | \$ 2,907 | \$ 2,281 | \$ 2,281 |

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 the value follows.

- A. 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. Since the discount rates are based on the Association'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. 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 as described above, with appropriately higher interest rates, which reflect the uncertainty of continued cash flows.

- B. Cash: The carrying value is a reasonable estimate of fair value.

- C. Note payable to AgBank: 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 interest rate that would be charged for borrowings. For purposes of this estimate, it is assumed the cash flow on the notes payable is equal to the principal payments on the Association's loan receivables plus accrued interest on the notes payable.
- D. Advance conditional payments: The carrying value is a reasonable estimate of fair value.

NOTE 15 – QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

Quarterly results of operations for the years ended December 31, 2008, 2007 and 2006, follow.

| | 2008 | | | | |
|------------------------------------------------|-----------------|---------------|-----------------|---------------|-----------------|
| | First | Second | Third | Fourth | Total |
| Net interest income | \$ 2,026 | \$ 1,930 | \$ 2,529 | \$ 2,122 | \$ 8,607 |
| (Loan loss reversal)/Provision for loan losses | (1,761) | 114 | (207) | 783 | (1,071) |
| Noninterest expenses, net | 897 | 1,083 | 1,116 | 1,151 | 4,247 |
| Net income | \$ 2,890 | \$ 733 | \$ 1,620 | \$ 188 | \$ 5,431 |

| | 2007 | | | | |
|------------------------------------------------|-----------------|---------------|-----------------|---------------|-----------------|
| | First | Second | Third | Fourth | Total |
| Net interest income | \$ 1,766 | \$ 1,708 | \$ 1,703 | \$ 1,758 | \$ 6,935 |
| (Loan loss reversal)/Provision for loan losses | (604) | 462 | (13) | (7) | (162) |
| Noninterest expenses, net | 724 | 816 | 695 | 869 | 3,104 |
| Net income | \$ 1,646 | \$ 430 | \$ 1,021 | \$ 896 | \$ 3,993 |

| | 2006 | | | | |
|------------------------------------------------|---------------|---------------|-----------------|-----------------|-----------------|
| | First | Second | Third | Fourth | Total |
| Net interest income | \$ 1,707 | \$ 1,667 | \$ 1,796 | \$ 1,782 | \$ 6,952 |
| Provision for loan losses/(Loan loss reversal) | 42 | 102 | (90) | (83) | (29) |
| Noninterest expenses, net | 797 | 723 | 687 | 841 | 3,048 |
| Net income | \$ 868 | \$ 842 | \$ 1,199 | \$ 1,024 | \$ 3,933 |

Report of Independent Auditors

To the Board of Directors and Shareholders of
Farm Credit of Western Oklahoma, ACA:

In our opinion, the accompanying consolidated statements of condition and the related consolidated statements of income, of changes in shareholders' equity, and of cash flows present fairly, in all material respects, the financial position of Farm Credit of Western Oklahoma, ACA and subsidiaries (the Association) at December 31, 2008, 2007 and 2006, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

February 27, 2009

DISCLOSURE INFORMATION REQUIRED BY FARM CREDIT ADMINISTRATION REGULATIONS

(Amounts in Whole Dollars)

DESCRIPTION OF BUSINESS

The description of the territory served, persons eligible to borrow, types of lending activities engaged in and financial services offered, and related Farm Credit organizations required to be disclosed in this section is incorporated herein by reference from Note 1 to the financial statements, "Organization and Operations," included in this annual report to shareholders.

The description of significant developments that had or could have a material impact on earnings or interest rates to borrowers, acquisitions or dispositions of material assets, material changes in the manner of conducting the business, seasonal characteristics, and concentrations of assets, if any, required to be disclosed in this section, is incorporated herein by reference from "Management's Discussion and Analysis" (MD&A) included in this annual report to shareholders.

DESCRIPTION OF PROPERTY

The following table sets forth certain information regarding the properties of the Association:

| Location | Description | Form of Ownership |
|--------------------------------------------|---------------------------------|-------------------|
| 3302 Williams Avenue Woodward, Oklahoma | Headquarters Office | Owned |
| 2600 Modelle Avenue Clinton, Oklahoma | Branch Office | Owned |
| 2143 Highway No. 64 Guymon, Oklahoma | Branch Office | Owned |
| 430 N. Broadway Taloga, Oklahoma | Satellite office | Owned |
| 219 Oklahoma Blvd Alva, Oklahoma | Branch Office | Owned |
| 101 Carter Road Elk City, Oklahoma | Branch Office opened in 2008 | Rented |
| 101 East 1st Street Cordell, Oklahoma | Satellite Office | Rented |
| 101 S. Douglas Beaver, Oklahoma | Satellite Office | Rented |

LEGAL PROCEEDINGS AND ENFORCEMENT ACTIONS

Information required to be disclosed in this section is incorporated herein by reference from Note 12 to the financial statements, "Regulatory Enforcement Matters," and Note 13 to the financial statements, "Commitments and Contingencies," included in this annual report to shareholders.

DESCRIPTION OF CAPITAL STRUCTURE

Information required to be disclosed in this section is incorporated herein by reference from Note 7 to the financial statements, "Shareholders' Equity," included in this annual report to shareholders.

DESCRIPTION OF LIABILITIES

The description of debt outstanding required to be disclosed in this section is incorporated herein by reference from Note 6 to the financial statements, "Note Payable to AgBank," included in this annual report to shareholders.

The description of advance conditional payments is incorporated herein by reference to Note 2 to the financial statements, "Summary of Significant Accounting Policies," to the financial statements, included in this annual report to shareholders.

The description of contingent liabilities required to be disclosed in this section is incorporated herein by reference from Note 13 included in this annual report to shareholders.

SELECTED FINANCIAL DATA

The selected financial data for the five years ended December 31, 2008, required to be disclosed in this section is incorporated herein by reference from the "Five-Year Summary of Selected Consolidated Financial Data," included in this annual report to shareholders.

MANAGEMENT'S DISCUSSION AND ANALYSIS

"Management's Discussion and Analysis," which appears within this annual report to shareholders and is required to be disclosed in this section, is incorporated herein by reference.

DIRECTORS AND SENIOR OFFICERS

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

DIRECTORS

- Ken Gore - Chairman. Mr. Gore has been a member of the board since November 1997. For the past five years he has been involved in the following agricultural enterprises: wheat, hay production, cow/calf, stockers and taking cattle in on a gain basis. His term expires in 2010.
- Steve Semmel - Vice-Chairman. Mr. Semmel was elected to the board in May 2003. For the past five years he has been involved in the following agricultural enterprises: wheat and hay production, cow/calf, stocker and feedlot cattle. He owns an interest in the Woodward NAPA, an auto parts store. and OK Rental Equipment, a generator and light tower rental business. Mr. Semmel has been treasurer for the Woodward Elks Rodeo, past director of the Northwest District – Oklahoma Cattlemen's Association and is past president of Northwest Oklahoma Cattlemen's Association. His term expires in 2009.
- Bobbie Apple - Director. Mr. Apple has been a member of the board since May 1992. For the past five years he has been involved in the following agricultural enterprises: cow/calf, stockers and taking cattle in on a gain basis. He is part owner and operator of Hitching Post Bed and Breakfast in Kenton. His term expires in 2011.
- James E. Hardy - Director. Mr. Hardy has been a member of the board since September 1986. For the past five years he has been involved in wheat and hay production, cow/calf, registered Angus cattle and stocker cattle. For the past 3½ years he has been the Activities Officer II at the William S. Key Correctional Facility, a minimum security prison. His term expires in 2011.
- Jimmie Musick - Director. Mr. Musick has been a member of the board since September 1988. For the past five years he has been involved in the following agricultural enterprises: alfalfa hay, wheat, cotton, milo and stocker cattle. He is part owner of Musick Farms, a family farming operation and an order buyer for Eastern Livestock. He is Vice President of Oklahoma Wheat Growers, Chairman of Washita County Health Board, and Chairman of the U.S. AgBank, FCB Stockholders Advisory Council. His term expires in 2010.
- LaVern Phillips - Appointed Director. Mr. Phillips served as appointed director on the board since February 1996. For the past five years he has been employed by Woodward Industrial Foundation, an economic development business, and serves on the Health Services Foundation, an elderly housing provider. His term expires in 2009.
- Jimmie Purvine - Director. Mr. Purvine was elected to the board in May 2005. For the past five years, he has been involved in the following agricultural enterprises: wheat, milo, soybeans, corn, silage, cow/calf and stockers. He is a former county committee member for Dewey Farm Service Agency and for the past two years has been a Board Member of the Dewey County Conservation District. His term expires in 2011.

- Clint Roush - Director. Mr. Roush has been a member of the board since June 1988. For the past five years he has been involved in the following agricultural enterprises: wheat, alfalfa hay, cotton and stocker and feeder cattle. He is president of Clint Roush Farms, Inc., a family farm corporation and manager of Roush Minerals, LLC, an oil and gas mineral ownership and management firm. He is also a Director and President of the Board of Directors for the Farmers Cooperative in Clinton, a grain and farm supply co-op. His term expires in 2009.
- Ronald W. White - Director. Mr. White has been a member of the board since June 1988. For the past five years he has been involved in the following agricultural enterprises: corn, wheat, milo and stocker cattle. He works part-time as a real estate appraiser, is the owner of R & K Trailers LLC, which leases livestock trailers to Brent White Transportation LLC, and is a director of Tri County Electric, a provider of electric power for the 3 panhandle counties. His term expires in 2009.

SENIOR OFFICERS

- John Grunewald - President and CEO. He has been employed in agricultural lending for the past 28 years. He began serving as President of the Clinton Production Credit Association in 1992. On July 1, 2002, the Federal Land Bank Association of Western Oklahoma, FLCA, the Production Credit Association of Woodward and Clinton Production Credit Association began a joint management agreement with Mr. Grunewald serving as President/CEO of all three associations and continuing with the formation of the ACA.
- Mike McDonald - Chief Credit Officer. He has been employed in agricultural lending for the past 17 years.
- Jamie Shirkey - Chief Financial Officer. She has been employed in agricultural lending for the past 29 years.
- Greg Livingston - Chief Lending Officer. He has been employed in agricultural lending for the past 17 years.
- Curtis Constien - Chief Operations Officer. He has been employed in agricultural lending for the past 28 years.

COMPENSATION OF DIRECTORS AND SENIOR OFFICERS

Directors of the Association were compensated for services on a per diem basis at the rate of \$400 per day, and were reimbursed mileage at the rate of \$0.505 per mile from January 1, 2008 through June 30, 2008 and \$0.585 per mile from July 1, 2008 through December 31, 2008, plus \$20 per hour driving time while on official business beginning in May 2008.

The Compensation and Audit committees were held in conjunction with the regular board meetings, so no additional compensation was paid to the directors for these meetings. However, three additional Audit committee meetings were held. Compensation for those meetings was \$400 per day, plus \$20 per hour driving time.

Additional information for each director is provided below:

| Name | Number of Days Served at | | Compensation for | | Total Compensation Paid During 2008 |
|--------------------|--------------------------|---------------------------|------------------------------------------|-----------------|-------------------------------------|
| | Board Meetings | Other Official Activities | Board Meetings and Other Official Duties | Audit Committee | |
| Ken Gore | 9 | 20.0 | \$ 10,940 | \$ 1,240 | \$ 12,180 |
| Steve Semmel | 8 | 17.0 | 10,380 | — | 10,380 |
| Bobbie L. Apple | 8 | 12.0 | 8,860 | — | 8,860 |
| James E. Hardy | 8 | 8.0 | 6,690 | — | 6,690 |
| Jimmie Musick | 9 | 19.0 | 12,090 | — | 12,090 |
| LaVern Phillips | 9 | 12.0 | 7,560 | 1,200 | 8,760 |
| Jimmie Purvine | 9 | 13.0 | 8,540 | 840 | 9,380 |
| Clint E. Roush | 8 | 18.0 | 9,850 | 820 | 10,670 |
| Ronald W. White | 8 | 12.5 | 7,840 | 880 | 8,720 |
| Total Compensation | | | \$ 82,750 | \$ 4,980 | \$ 87,730 |

Directors and senior officers are reimbursed for travel, subsistence and other expenses related to Association business according to Association policy. A copy of this policy is available to shareholders upon request. Aggregate reimbursements to directors for travel, subsistence and other related expenses were \$85,335 in 2008, \$85,536 in 2007 and \$93,567 in 2006. There was no non-cash compensation paid to directors as a group during 2008.

Required senior officer compensation information is included in the Association's Annual Meeting Information Statement (AMIS) mailed to all shareholders. The AMIS is available for public inspection at the Association office. Disclosure of information on the total compensation paid during the last fiscal year to any senior officer, or to any other officer included, is available and will be disclosed to shareholders upon request.

TRANSACTIONS WITH SENIOR OFFICERS AND DIRECTORS

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

INVOLVEMENT OF SENIOR OFFICERS AND DIRECTORS IN CERTAIN LEGAL PROCEEDINGS

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

RELATIONSHIP WITH U.S. AgBANK, FCB (AgBANK)

The Association's statutory obligation to borrow from AgBank is discussed in Note 6. Financial assistance agreements between the Association and AgBank are discussed in Note 7. Association requirement to invest in AgBank and AgBank's ability to access capital of the Association is discussed in Note 4 to the financial statements, "Investment in AgBank." AgBank's role in mitigating the Association's exposure to interest rate risk is discussed in the MD&A section – Liquidity.

AgBank is required to distribute its Annual Report to shareholders of the Association if a "significant event," as defined by FCA regulations occurs.

RELATIONSHIP WITH INDEPENDENT AUDITORS

There were no changes in independent auditors since the prior annual report to shareholders and there were no material disagreements with our independent auditors on any matter of accounting principles or financial statement disclosure during this period.

FINANCIAL STATEMENTS

The financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated February 27, 2009, and the Report of Management, appearing as part of this annual report to shareholders, are incorporated herein by reference.

AgBANK ANNUAL AND QUARTERLY REPORTS TO SHAREHOLDERS

The shareholders' investment in the Association is materially affected by the financial condition and results of operations of AgBank. Consequently, the Association's annual and quarterly reports should be read in conjunction with AgBank's Annual and Quarterly Reports to Shareholders. Quarterly reports are available approximately 40 days after the calendar quarter end and annual reports are available approximately 75 days after the calendar year end. A copy of these reports may be obtained free upon request from the Association. The Association is located at 3302 Williams Avenue, Woodward, Oklahoma 73801-6944, or may be contacted by calling (580)-256-3465. The reports may also be obtained free of charge by visiting AgBank's website at www.usagbank.com.