

# THIRD QUARTER 2009

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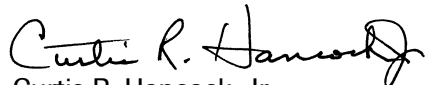
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## CERTIFICATION

The undersigned certify that we have reviewed the September 30, 2009 quarterly report of Jackson Purchase Agricultural Credit Association, that the report has been prepared under the oversight of the Audit Committee of the Board of Directors and in accordance with all applicable statutory or regulatory requirements, and that the information contained herein is true, accurate, and complete to the best of our knowledge and belief.



Stan Brunston  
Chief Executive Officer



Curtis R. Hancock, Jr.  
Chairman of the Board



Barbara Davis  
Chief Financial Officer



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

October 22, 2009

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*Jackson Purchase Agricultural Credit Association*

# Report on Internal Control Over Financial Reporting

The Association's principal executives and principal financial officers, or persons performing similar functions, are responsible for establishing and maintaining adequate internal control over financial reporting for the Association's Consolidated Financial Statements. For purposes of this report, "internal control over financial reporting" is defined as a process designed by, or under the supervision of the Association's principal executives and principal financial officers, or persons performing similar functions, and effected by its Board of Directors, management and other personnel. This process provides reasonable assurance regarding the reliability of financial reporting information and the preparation of the Consolidated Financial Statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

Internal control over financial reporting includes those policies and procedures that: (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Association, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial information in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures are being made only in accordance with authorizations of management and directors of the Association, and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Association's assets that could have a material effect on its Consolidated Financial Statements.

The Association's management has completed an assessment of the effectiveness of internal control over financial reporting as of September 30, 2009. In making the assessment, management used the framework in *Internal Control — Integrated Framework*, promulgated by the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as the "COSO" criteria.

Based on the assessment performed, the Association concluded that as of September 30, 2009, the internal control over financial reporting was effective based upon the COSO criteria. Additionally, based on this assessment, the Association determined that there were no material weaknesses in the internal control over financial reporting as of September 30, 2009



Stan Brunston  
Chief Executive Officer



Barbara Davis  
Chief Financial Officer

October 22, 2009

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

*(dollars in thousands)*

The following commentary reviews the financial condition and results of operations of Jackson Purchase, ACA (Association) for the period ended September 30, 2009. These comments should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated financial statements and the 2008 Annual Report of the Association. The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors.

## **LOAN PORTFOLIO**

The Association provides funds to farmers, rural homeowners and farm-related businesses for financing of short and intermediate-term loans and long-term real estate mortgage loans. The Association's loan portfolio is diversified over a range of agricultural commodities including corn, soybeans, poultry, and tobacco. Farm size varies and many of the borrowers in the region have diversified farming operations. This factor, along with the numerous opportunities for non-farm income in the area, somewhat reduces the level of dependency on any single commodity.

The gross loan volume of the Association as of September 30, 2009, was \$254,566, a decrease of \$9,170, as compared to \$263,736 at December 31, 2008. Net loans outstanding at September 30, 2009, were \$251,433 as compared to \$261,965 at December 31, 2008. Net loans accounted for 90.76 percent of total assets at September 30, 2009, as compared to 88.82 percent of total assets at December 31, 2008. The decrease in gross and net loan volume during the reporting period is primarily attributable to seasonal paydown on production loans and the reduced need for additional credit due to the bountiful harvest in 2008.

There is an inherent risk in the extension of any type of credit. Portfolio credit quality continues to be maintained at an acceptable level and credit administration remains satisfactory. Nonaccrual loans increased from \$2,017 at December 31, 2008, to \$6,554 at September 30, 2009. This increase is primarily the result of ten borrower's loans (including five participation loans) being transferred to nonaccrual status during the period.

Other property owned (OPO) consists primarily of assets once held as loan collateral that were acquired through foreclosure or deeded to the Association (or a lender group) in satisfaction of secured loans. Traditionally, OPO is primarily in the form of

real estate. However, it can also include equipment and equity interests in companies or partnerships. OPO totaled \$77 at September 30, 2009 compared to \$0 at December 31, 2008. This increase is primarily due to one nonaccrual loan that was transferred into OPO.

Association management maintains an allowance for loan losses in an amount considered sufficient to absorb possible losses in the loan portfolio based on current and expected future conditions. The allowance for loan losses at September 30, 2009, was \$3,133 compared to \$1,771 at December 31, 2008, and was considered by management to be adequate to cover probable losses. The increase of \$1,362 in the allowance for loan losses was primarily the result of classification changes, chargeoffs, and additional specific reserves needed for participation loans.

## **RESULTS OF OPERATIONS**

### ***For the three months ended September 30, 2009***

Net income for the three months ended September 30, 2009, totaled \$524, as compared to \$1,448 for the same period in 2008. Net interest income decreased \$186 for the three months ended September 30, 2009, as compared to the same period in 2008. This decrease in net interest income is attributed primarily to a decrease in interest income and expense as a result of loans sold to AgFirst through the Capitalized Participation Pool (CPP) program.

Noninterest income for the three months ended September 30, 2009, totaled \$1,096 as compared to \$1,167 for the same period of 2008, a decrease of \$71. The decrease is primarily the result of a decrease fees for financially related services. Noninterest expense for the three months ended September 30, 2009, increased \$234 compared to the same period of 2008. The primary reason for the increase in noninterest expense resulted from an increase in salaries and employee benefits and occupancy and equipment expenses.

Nonaccrual income was \$(1) for the three months ended September 30, 2009, as compared to \$6 for the same period in 2008. This decrease is mainly the result of one loan that paid off that had deferred interest income. The Association recorded a provision for loan loss of \$664 for the three months ended September 30, 2009, as compared to \$232 for the same period in 2008. The increase in provision for loan loss is attributed to classification changes and specific reserves needed for participation loans.

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### ***For the nine months ended September 30, 2009***

Net income for the nine months ended September 30, 2009, totaled \$1,232, as compared to \$3,985 for the same period in 2008. Net interest income decreased \$593 for the nine months ended September 30, 2009, as compared to the same period in 2008. This decrease in net interest income is attributed primarily to a decrease in interest income and expense as a result of loans sold to AgFirst through the Capitalized Participation Pool (CPP) program.

Noninterest income for the nine months ended September 30, 2009, totaled \$3,029, as compared to \$2,626 for the same period of 2008, an increase of \$403. The increase is primarily the result of an increase in equity in earnings of other Farm Credit institutions. Noninterest expense for the nine months ended September 30, 2009, increased \$648 compared to the same period of 2008. The primary reason for the increase in noninterest expense resulted from an increase in salaries and employee benefits, and occupancy and equipment expenses.

Nonaccrual income was \$289 for the nine months ended September 30, 2009, as compared to \$42 for the same period in 2008. This increase is mainly the result of one loan that paid off that had deferred interest income. The Association recorded a provision for loan loss of \$2,150 for the nine months ended September 30, 2009, as compared to \$232 for the same period in 2008. The increase in provision for loan loss is attributed to classification changes and specific reserves needed for participation loans.

### **FUNDING SOURCES**

The principal source of funds for the Association is the borrowing relationship established with AgFirst Farm Credit Bank (the Bank) through a General Financing Agreement. The General Financing Agreement utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The Bank advances funds to the Association in the form of notes payable. The notes payable are segmented into variable rate and fixed rate sections. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association and approximately 54% of the Association's own funds. The total notes payable to the Bank at September 30, 2009, was \$228,518 compared to \$237,734 at December 31, 2008.

### **CAPITAL RESOURCES**

Total members' equity at September 30, 2009, increased to \$42,687 from the December 31, 2008, total of \$42,372. The increase is primarily attributed to income generated through the first three quarters.

Total capital stock and participation certificates were \$2,003 on September 30, 2009, compared to \$2,015 on December 31, 2008.

Farm Credit Administration (FCA) regulations require all Farm Credit institutions to maintain minimum permanent capital, total surplus and core surplus ratios. These ratios are calculated by dividing the Association's permanent capital, total surplus and core surplus as defined in FCA regulations, by a risk-adjusted asset base. As of September 30, 2009, the Association's total surplus ratio and core surplus ratio were 14.59 percent and 13.51 percent, respectively, and the permanent capital ratio was 15.51 percent. All three ratios were well above the minimum regulatory ratios of 7.00 percent for permanent capital and total surplus ratios and 3.50 percent for the core surplus ratio.

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**NOTE:** Shareholder investment in the Association could be affected by the financial condition and results of operations of AgFirst Farm Credit Bank. Copies of AgFirst's annual and quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 378, or writing Stephen Gilbert, AgFirst Farm Credit Bank, P.O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained at their website, [www.agfirst.com](http://www.agfirst.com). Copies of the Association's annual and quarterly reports are also available upon request free of charge by calling (270) 247-5613, writing Barbara Davis, Chief Financial Officer, Jackson Purchase ACA, P. O. Box 309, Mayfield, KY 42066, or accessing the website, [www.jacksonpurchaseaca.com](http://www.jacksonpurchaseaca.com). The Association prepares a quarterly report within 40 days after the end of each fiscal quarter, except that no report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution.

# Jackson Purchase Agricultural Credit Association

## Consolidated Balance Sheets

<i>(dollars in thousands)</i>	<b>September 30, 2009</b> <i>(unaudited)</i>	<b>December 31, 2008</b> <i>(audited)</i>
<b>Assets</b>		
Cash	\$ 177	\$ 2,860
Investment securities:		
Held to maturity (fair value of \$7,611 and \$9,816 respectively)	7,637	9,889
Total investment securities	7,637	9,889
Loans	254,566	263,736
Less: allowance for loan losses	3,133	1,771
Net loans	251,433	261,965
Loans held for sale	—	352
Other investments	2,611	2,901
Accrued interest receivable	3,390	4,290
Investment in other Farm Credit institutions	7,293	7,881
Premises and equipment, net	1,789	1,415
Other property owned	77	—
Due from AgFirst Farm Credit Bank	2,202	2,510
Other assets	433	860
Total assets	\$ 277,042	\$ 294,923
<b>Liabilities</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 228,518	\$ 237,734
Accrued interest payable	585	741
Patronage refund payable	17	1,460
Advanced conditional payments	3,693	5,716
Other liabilities	1,542	6,900
Total liabilities	234,355	252,551
Commitments and contingencies		
<b>Members' Equity</b>		
Capital stock and participation certificates	2,003	2,015
Retained earnings		
Allocated	15,705	16,553
Unallocated	24,979	23,804
Total members' equity	42,687	42,372
Total liabilities and members' equity	\$ 277,042	\$ 294,923

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

# Jackson Purchase Agricultural Association

## Consolidated Statements of Income

*(unaudited)*

<i>(dollars in thousands)</i>	<b>For the three months ended September 30,</b>		<b>For the nine months ended September 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
<b>Interest Income</b>				
Investment securities	\$ 31	\$ 82	\$ 98	\$ 322
Loans	3,214	4,346	9,744	13,851
Other	35	36	103	111
Total interest income	3,280	4,464	9,945	14,284
<b>Interest Expense</b>				
Notes payable to AgFirst Farm Credit Bank	1,756	2,694	5,259	8,831
Other	7	67	55	229
Total interest expense	1,763	2,761	5,314	9,060
Net interest income	1,517	1,703	4,631	5,224
Provision for (reversal of allowance for) loan losses	664	232	2,150	232
Net interest income after provision for (reversal of allowance for) loan losses	853	1,471	2,481	4,992
<b>Noninterest Income</b>				
Loan fees	56	51	200	296
Fees for financially related services	264	417	431	574
Equity in earnings of other Farm Credit institutions	743	676	2,201	1,656
Gains (losses) on sale of rural home loans, net	25	16	162	55
Other noninterest income	8	7	35	45
Total noninterest income	1,096	1,167	3,029	2,626
<b>Noninterest Expense</b>				
Salaries and employee benefits	921	724	2,829	2,274
Occupancy and equipment	107	69	283	228
Insurance Fund premium	92	77	259	264
Other operating expenses	305	321	907	864
Total noninterest expense	1,425	1,191	4,278	3,630
Income before income taxes	524	1,447	1,232	3,988
Provision (benefit) for income taxes	—	(1)	—	3
Net income	\$ 524	\$ 1,448	\$ 1,232	\$ 3,985

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

Jackson Purchase Agricultural Credit Association  
**Consolidated Statements of Changes in  
Members' Equity**

*(unaudited)*

<i>(dollars in thousands)</i>	<b>Capital Stock and Participation Certificates</b>	<b>Retained Earnings</b>		<b>Total Members' Equity</b>
		<b>Allocated</b>	<b>Unallocated</b>	
Balance at December 31, 2007	\$ 1,988	\$ 14,541	\$ 23,182	\$ 39,711
Net income			3,985	3,985
Capital stock/participation certificates issued/(retired), net	48			48
Retained earnings retired		(725)		(725)
Patronage distribution adjustment		58	(92)	(34)
Balance at September 30, 2008	<u>\$ 2,036</u>	<u>\$ 13,874</u>	<u>\$ 27,075</u>	<u>\$ 42,985</u>
Balance at December 31, 2008	\$ 2,015	\$ 16,553	\$ 23,804	\$ 42,372
Net income			1,232	1,232
Capital stock/participation certificates issued/(retired), net	(12)			(12)
Retained earnings retired		(885)		(885)
Patronage distribution adjustment		37	(57)	(20)
Balance at September 30, 2009	<u>\$ 2,003</u>	<u>\$ 15,705</u>	<u>\$ 24,979</u>	<u>\$ 42,687</u>

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

## Notes to the Consolidated Financial Statements

(dollars in thousands, except as noted)  
(unaudited)

### **NOTE 1 – ORGANIZATION, SIGNIFICANT ACCOUNTING POLICIES, AND RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

The accompanying financial statements include the accounts of Jackson Purchase Agricultural Credit Association (the Association). A description of the organization and operations of the Association, the significant accounting policies followed, and the financial condition and results of operations as of and for the year ended December 31, 2008, are contained in the 2008 Annual Report to Shareholders. These unaudited third quarter 2009 consolidated financial statements should be read in conjunction with the 2008 Annual Report to Shareholders.

The accompanying consolidated financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations and conform with generally accepted accounting principles (GAAP) and prevailing practices within the banking industry. The results for the nine months ended September 30, 2009, are not necessarily indicative of the results to be expected for the year ending December 31, 2009.

Certain amounts in the prior period's consolidated financial statements may have been reclassified to conform to the current period's consolidated financial statement presentation. Such reclassifications had no effect on the prior period net income or total capital as previously reported.

The Association maintains an allowance for loan losses in accordance with GAAP. The loan portfolio is reviewed quarterly to determine the adequacy of the allowance for losses. As of September 30, 2009, the allowance for losses is adequate in management's opinion to provide for possible losses on existing loans.

In addition to the recently issued accounting pronouncements discussed in the 2008 Annual Report to Shareholders, effective January 1, 2009, the Association adopted accounting guidance for fair value measurements of nonfinancial assets and nonfinancial liabilities. The impact of adoption resulted in additional fair value disclosures (see Note 5), primarily regarding other property owned, but does not have an impact on the Association's financial condition or results of operations.

In April 2009, the Financial Accounting Standards Board (FASB) issued guidance, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have

Significantly Decreased and Identifying Transactions That Are Not Orderly". The guidance emphasizes that even if there has been a significant decrease in the volume and level of activity for the asset or liability and regardless of the valuation technique and inputs used, the objective for the fair value measurement is unchanged from what it would be if markets were operating at normal activity levels or transactions were orderly; that is, to determine the current exit price. It sets forth additional factors that should be considered to determine whether there has been a significant decrease in volume and level of activity when compared with normal market activity. The reporting entity shall evaluate the significance and relevance of the factors to determine whether, based on the weight of evidence, there has been a significant decrease in activity and volume. The guidance indicates that if an entity determines that either the volume or level of activity for an asset or liability has significantly decreased (from normal conditions for that asset or liability) or price quotations or observable inputs are not associated with orderly transactions, increased analysis and management judgment will be required to estimate fair value. It is further noted that a fair value measurement should include a risk adjustment to reflect the amount market participants would demand because of the risk (uncertainty) in the cash flows.

This guidance also requires a reporting entity to make additional disclosures in interim and annual periods. Revisions resulting from a change in valuation techniques or their application are accounted for as a change in accounting estimate. The Association adopted this guidance effective June 30, 2009 (see Note 2 and Note 5).

In April 2009, the FASB issued guidance, "Recognition and Presentation of Other-Than-Temporary Impairments", which amends the other-than-temporary impairment guidance for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt securities in the financial statements. It does not change existing recognition and measurement guidance related to other-than-temporary impairments of equity securities.

This guidance changes existing impairment guidance related to accounting for certain investments in debt and equity securities by eliminating the "ability and intent to hold" provision. In addition, impairment is now considered to be other than temporary if an entity 1) intends to sell the security, 2) more likely than not will be required to sell the security before recovering its cost, or 3) does not expect to

recover the security's entire amortized cost basis (even if the entity does not intend to sell). The "probability" standard relating to the collectability of cash flows is also eliminated, and impairment is now considered to be other-than-temporary if the present value of cash flows expected to be collected from the debt security is less than the amortized cost basis of the security (any such shortfall is referred to as a "credit loss"). If an entity intends to sell an impaired debt security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the impairment is other-than-temporary and should be recognized currently in earnings in an amount equal to the entire difference between fair value and amortized cost. If a credit loss exists, but an entity does not intend to sell the impaired debt security and is not more likely than not to be required to sell before recovery, the impairment is other-than-temporary and should be separated into 1) the estimated amount relating to credit loss, and 2) the amount relating to all other factors. Only the estimated credit loss amount is recognized currently in earnings, with the remainder of the loss amount recognized in other comprehensive income. For held-to-maturity securities, the portion of the other-than-temporary impairment not related to a credit loss will be recognized in a new category of other comprehensive income and amortized over the remaining life of the debt security as an increase in the security's carrying amount. Disclosure requirements for impaired debt and equity securities are expanded and will now be required quarterly (see Note 2), as well as annually.

The Association adopted this guidance effective June 30, 2009. For securities held at the beginning of the interim period of adoption for which an other-than-temporary impairment was previously recognized, if an entity does not intend to sell and it is not more likely than not that it will be required to sell before recovery of its amortized cost basis, the entity shall recognize the cumulative effect of initially applying this guidance as an adjustment to the opening balance of retained earnings with a corresponding adjustment to accumulated other comprehensive income. There was no initial adjustment to apply this guidance for the Association since no other-than-temporary impairment was previously recognized by the Association.

In April 2009, the FASB issued guidance, "Interim Disclosures about Fair Value of Financial Instruments." This guidance requires disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. The Association adopted this guidance effective June 30, 2009 (see Note 6).

In May 2009, the FASB issued guidance, "Subsequent Events," which sets forth general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. There are two types of subsequent

events: the first type consists of events or transactions that provide additional evidence about conditions that existed at the balance sheet date (recognized subsequent events) and the second type consists of events that provide evidence about conditions that did not exist at the balance sheet date but arose after that date (nonrecognized subsequent events). Recognized subsequent events should be included in the financial statements since the conditions existed at the date of the balance sheet. Nonrecognized subsequent events are not included in the financial statements since the conditions arose after the balance sheet date but before the financial statements are issued or are available to be issued. This guidance, which includes a required disclosure of the date through which an entity has evaluated subsequent events, was adopted by the Association effective June 30, 2009 (see Note 7).

In June 2009, the FASB issued guidance, "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles." This Codification became the source of authoritative U.S. generally accepted accounting principles recognized by the FASB. This guidance was adopted by the Association effective July 1, 2009 and had no impact on the Association's financial condition or results of operations.

## NOTE 2 — INVESTMENT SECURITIES

A summary of the amortized cost and fair value of investment securities held-to-maturity at September 30, 2009 and December 31, 2008 follows:

	September 30, 2009				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
Asset backed securities	\$ 7,637	\$ 4	\$ (30)	\$ 7,611	1.76 %

	December 31, 2008				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Yield
Asset backed securities	\$ 9,889	\$ -	\$ (73)	\$ 9,816	2.92 %

A summary of the expected maturity, amortized cost and estimated fair value of investment securities at September 30, 2009 follows:

	September 30, 2009		
	Amortized Cost	Fair Value	Weighted Average Yield
In one year or less	\$ 2,441	\$ 2,433	1.63%
After one year through five years	5,033	5,018	1.83
After five years through ten years	163	160	1.52
After ten years	-	-	-
Total	\$ 7,637	\$ 7,611	1.76%

The Association's investments consist primarily of asset-backed securities (ABSs). These ABSs are rated AAA, as they

are guaranteed by the full faith and credit of the United States government. Unrealized losses at September 30, 2009 are primarily due to reduced liquidity in the securities markets stemming from general adversity in the financial markets and are not credit related.

The following table shows the fair value and gross unrealized losses for investments in a loss position by the length of time the securities have been in a continuous unrealized loss position at September 30, 2009. The continuous loss position is based on the date the impairment occurred. The Association performs periodic credit reviews, including other-than-temporary impairment analysis, on its investment securities portfolio. The objective is to quantify any future possible loss of principal or interest due on each security identified for additional analysis. Based on the results of all analyses, the Association has not recognized any other-than-temporary impairment in connection with these investments. The unrealized losses on these investments resulted primarily from reduced liquidity in the securities markets stemming from general adversity in the financial markets. The Association has the ability and intent to hold these investments until a recovery of unrealized losses occurs, which may be at maturity, and at this time expects to collect the full principal amount and interest due on these securities, especially after considering credit enhancements. All securities continue to perform. Substantially all of these investments were in U. S. government securities and the Association expects that these securities would not be settled at a price less than their amortized cost.

	<b>September 30, 2009</b>			
	<b>Less than 12 Months</b>		<b>Greater than 12 Months</b>	
	<b>Fair Value</b>	<b>Unrealized Losses</b>	<b>Fair Value</b>	<b>Unrealized Losses</b>
Asset-backed securities	\$ -	\$ -	\$ 5,279	\$ (30)

### NOTE 3 – ALLOWANCE FOR LOAN LOSSES AND IMPAIRED LOANS

An analysis of the allowance for loan losses follows:

	<b>For the nine months ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
Balance at beginning of period	\$ 1,771	\$ 1,039
Provision for (reversal of) loan losses	2,150	232
Charge-offs	(789)	-
Recoveries	1	-
Balance at end of period	<u>\$ 3,133</u>	<u>\$ 1,271</u>

The following table presents information concerning impaired loans as of September 30,

	<b>2009</b>	<b>2008</b>
Impaired loans with related allowance	\$ 5,412	\$ 1,631
Impaired loans with no related allowance	1,152	309
Total impaired loans	<u>6,564</u>	<u>1,940</u>
Allowance on impaired loans	<u>\$ 1,587</u>	<u>\$ 451</u>

The following table summarizes impaired loan information for the nine months ended September 30,

	<b>2009</b>	<b>2008</b>
Average impaired loans	\$ 3,499	\$ 1,787
Interest income recognized on impaired loans	296	105

### NOTE 4 – EMPLOYEE BENEFIT PLANS

The following is a table of retirement and other postretirement benefit expenses for the Association:

	<b>For the nine months ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
Pension	\$ 425	\$ 114
401(k)	105	95
Other postretirement benefits	(9)	(8)
Total	<u>\$ 521</u>	<u>\$ 201</u>

The following is a table of retirement and other postretirement benefit contributions for the Association:

	<b>Actual YTD Through 9/30/09</b>	<b>Projected Contributions For Remainder of 2009</b>	<b>Projected Total Contributions 2009</b>
Pension	\$ -	\$ 737	\$ 737
Other postretirement benefits	1	-	1
Total	<u>\$ 1</u>	<u>\$ 737</u>	<u>\$ 738</u>

As of September 30, 2009, no contributions have been made to the pension plan for 2009. Actuarial calculations as of the last plan measurement date (December 31, 2008) projected contributions of \$1,785 to the pension plan for 2009. However, a new funding policy adopted during 2009 by the plan's Sponsor Committee resulted in a revised \$737 projected total contribution for 2009 as shown in the table above. Market conditions could impact discount rates and return on plan assets which could make additional contributions necessary before the next plan measurement date of December 31, 2009.

Further details regarding employee benefit plans are contained in the 2008 Annual Report to Shareholders.

## NOTE 5 – FAIR VALUE MEASUREMENT

Effective January 1, 2008, the Association adopted FASB guidance on fair value measurements. This guidance defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements for certain assets and liabilities measured at fair value on a recurring and non-recurring basis. These assets and liabilities primarily consist of standby letters of credit, impaired loans, and other property owned.

This guidance defines fair value as 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.

This guidance establishes a fair value hierarchy for disclosure of fair value measurements to maximize the use of observable inputs, that is, inputs that reflect the assumptions market participants would use in pricing an asset or liability based on market data obtained from sources independent of the reporting entity. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The three levels of inputs and the classification of the Association's financial instruments within the fair value hierarchy are as follows:

### Level 1

Level 1 inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets. The Association has no Level 1 assets or liabilities measured at fair value on a recurring basis at September 30, 2009.

### Level 2

Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets; quoted prices in markets that are not active; and inputs that are observable, or can be corroborated, for substantially the full term of the asset or liability. The Association has no Level 2 assets and liabilities measured at fair value on a recurring basis at September 30, 2009.

### Level 3

Level 3 inputs to the valuation methodology are unobservable and supported by little or no market activity. Valuation is determined using pricing models, discounted cash flow methodologies, or similar techniques, and could include significant management judgment or estimation. Level 3 assets and liabilities include instruments whose price has been adjusted based on dealer quoted pricing that is different than the third-party valuation or internal model pricing.

Level 3 assets at September 30, 2009 include impaired loans which represent the fair value of certain loans that were evaluated for impairment under FASB guidance. The fair value was based upon the underlying collateral since these were collateral-dependent loans. The fair value measurement process uses independent appraisals and other market-based information, but in many cases it also requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the collateral and other matters. As a result, these fair value measurements fall within Level 3 of the hierarchy. When the value of the collateral, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established. Other property owned is classified as a level 3 asset at September 30, 2009. The fair value for other property owned is based upon the collateral less estimated costs to sell. Level 3 liabilities at September 30, 2009 include standby letters of credit whose market value is internally calculated based on information that is not observable either directly or indirectly in the marketplace.

### Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following table presents the assets and liabilities that are measured at fair value on a recurring basis at September 30, 2009 for each of the fair value hierarchy levels:

	September 30, 2009			Total Fair Value
	Level 1	Level 2	Level 3	
<b>Liabilities:</b>				
Standby letters of credit	\$ -	\$ -	\$ 37	\$ 37
Total Liabilities	\$ -	\$ -	\$ 37	\$ 37

The following table presents the changes in Level 3 assets and liabilities measured at fair value on a recurring basis:

	<b>Standby Letters Of Credit</b>
Balance at January 1, 2009	\$ 46
<b>Total gains or (losses) realized/unrealized:</b>	
Included in earnings	-
Included in other comprehensive loss	-
Purchases, sales, issuances and settlements, net	(9)
Transfers in and/or out of level 3	-
Balance at September 30, 2009	<u>\$ 37</u>

### Assets and Liabilities Measured at Fair Value on a Non-recurring Basis

Assets and liabilities measured at fair value on a non-recurring basis at September 30, 2009 for each of the fair value hierarchy values are summarized below:

	September 30, 2009				YTD Total Gains (Losses)
	Level 1	Level 2	Level 3	Total Fair Value	
<b>Assets:</b>					
Impaired loans	\$ -	\$ -	\$ 3,824	\$ 3,824	\$ (1,959)
Other property owned	\$ -	\$ -	\$ 77	\$ 77	\$ -

### NOTE 6 — DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

The following table presents the carrying amounts and fair values of the Association's financial instruments at September 30, 2009.

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

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

	<b>September 30, 2009</b>	
	<b>Carrying Amount</b>	<b>Estimated Fair Value</b>
<b>Financial assets:</b>		
Cash	\$ 177	\$ 177
Loans, net of allowance	\$ 251,433	\$ 255,982
Investment securities	\$ 7,637	\$ 7,611
Tobacco Buyout SIIC	\$ 2,611	\$ 2,808
<b>Financial liabilities:</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 228,518	\$ 231,559

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

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

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

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

The carrying value of accrued interest approximates its fair value.

- C. **Investment Securities:** Fair value is based upon quoted market price.
- D. **Investment in AgFirst Farm Credit Bank and Other Farm Credit Institutions:** Estimating the fair value of the Association's investment in the Bank and Other Farm Credit Institutions is not practicable because the stock is not traded. The net investment is a requirement of borrowing from the Bank and is carried at cost plus allocated equities in the accompanying Consolidated

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Balance Sheets. The Association owns 1.89 percent of the issued stock of the Bank as of September 30, 2009 net of any reciprocal investment. As of that date, the Bank's assets totaled \$30.08 billion and shareholders' equity totaled \$1.60 billion. The Bank's earnings were \$194.0 million during the first nine months of 2009.

In addition, the Association has an investment of \$74 related to other Farm Credit institutions.

- E. **Notes Payable to AgFirst Farm Credit Bank:** The notes payable are segregated into pricing pools according to the types and terms of the loans (or other assets) which they fund. Fair value of the notes payable is estimated by discounting the anticipated cash flows of each pricing pool using the current rate that would be charged for additional borrowings. For purposes of this estimate it is assumed the cash flow on the notes is equal to the principal payments on the Association's loan receivables plus accrued interest on the notes payable. This assumption implies that earnings on the Association's interest margin are used to fund operating expenses and capital expenditures.
- F. **Commitments to Extend Credit:** The estimated market value of off-balance-sheet commitments is minimal since the committed rate approximates current rates offered for commitments with similar rate and maturity characteristics and since the related credit risk is not significant.
- G. **Tobacco Buyout SIIC:** Fair value is determined by discounting the expected future cash flows using current interest rates for similar assets.

#### **NOTE 7 – SUBSEQUENT EVENTS**

The Association has evaluated subsequent events and has determined there are none requiring disclosure through November 3, 2009, which is the date the financial statements were available to be issued.