

2007

ANNUAL REPORT

*FARM CREDIT
OF SOUTHWEST KANSAS, ACA*

Five-Year Summary of Selected Consolidated Financial Data

(Dollars in Thousands)

	December 31				
	2007	2006	2005	2004	2003
Statement of Condition Data					
Loans	\$ 403,750	\$ 399,553	\$ 394,631	\$ 395,542	\$ 381,310
Less allowance for loan losses	2,457	1,497	2,926	2,190	14,245
Net loans	401,293	398,056	391,705	393,352	367,065
Investment in U.S. AgBank, FCB	17,705	17,705	16,797	15,981	15,441
Other property owned	2,750	2,519	-	174	174
Other assets	21,769	17,686	14,922	12,753	13,246
Total assets	\$ 443,517	\$ 435,966	\$ 423,424	\$ 422,260	\$ 395,926
Obligations with maturities of one year or less	\$ 16,654	\$ 10,208	\$ 8,959	\$ 10,137	\$ 11,916
Obligations with maturities longer than one year	312,990	316,546	312,422	311,768	300,437
Total liabilities	329,644	326,754	321,381	321,905	312,353
Protected borrower stock	89	92	102	124	147
Capital stock	1,085	1,138	1,575	1,606	1,599
Unallocated retained earnings	112,627	107,982	100,366	98,625	81,827
Accumulated other comprehensive income	72	-	-	-	-
Total shareholders' equity	113,873	109,212	102,043	100,355	83,573
Total liabilities and shareholders' equity	\$ 443,517	\$ 435,966	\$ 423,424	\$ 422,260	\$ 395,926

	For the Year Ended December 31				
	2007	2006	2005	2004	2003
Statement of Income Data					
Net interest income	\$ 12,688	\$ 11,886	\$ 11,386	\$ 11,633	\$ 11,850
Patronage distribution from U.S. AgBank, FCB	3,060	2,996	2,552	1,681	5,287
Provision for loan losses/(Loan loss reversal)	521	(2,686)	4,181	(12,117)	-
Noninterest expense, net	5,365	5,876	5,201	5,544	6,200
Provision for income taxes	217	76	65	589	148
Net income	\$ 9,645	\$ 11,616	\$ 4,491	\$ 19,298	\$ 10,789

Key Financial Ratios**For the Year**

Return on average assets	2.18%	2.70%	1.06%	4.72%	2.70%
Return on average shareholders' equity	8.43%	11.00%	4.44%	20.98%	13.66%
Net interest income as a percentage of average earning assets	3.13%	2.99%	2.88%	2.99%	3.07%
Net (recoveries)/charge-offs as a percentage of average net loans	(0.11%)	(0.32%)	0.88%	(0.02%)	0.13%

At Year End

Shareholders' equity as a percentage of total assets	25.68%	25.05%	24.10%	23.77%	21.11%
Debt as a ratio to shareholders' equity	2.89:1	2.99:1	3.15:1	3.21:1	3.74:1
Allowance for loan losses as a percentage of loans	0.61%	0.37%	0.74%	0.55%	3.74%
Permanent capital ratio	25.62%	23.47%	22.19%	20.31%	19.25%
Core surplus ratio	22.46%	21.27%	20.01%	18.15%	17.09%
Total surplus ratio	25.38%	23.21%	21.83%	19.91%	18.84%

Net Income Distribution

Cash patronage distributions paid	\$ 4,000	\$ 2,750	\$ 2,500	\$ 1,500	\$ 2,000
Patronage distributions payable	\$ 5,000	\$ 4,000	\$ 2,750	\$ 2,500	\$ 1,500

Other

Loans serviced for U.S. AgBank, FCB	\$ 80	\$ 155	\$ 179	\$ 223	\$ 377
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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 Southwest Kansas, ACA, for the year ended December 31, 2007. 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 the 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 Risk Management
- Capital Resources
- Regulatory Matters
- Governance
- Forward-Looking Information
- Critical Accounting Policies and Estimates
- Customer Privacy

Our annual and quarterly reports to shareholders are available on our website, www.farmcreditconnect.com, or may be obtained free of charge by calling (620) 275-4281. Annual reports are available on our website within 75 days after year end and quarterly reports are available on our website within 40 days after the calendar quarter end.

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 to credit-worthy individuals and businesses. 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 of southwestern Kansas. 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 AgBank Annual Report to Shareholders, the AgBank District Annual Report to Shareholders and the AgBank and AgBank District's quarterly reports are available on AgBank's web site, www.usagbank.com, or may be obtained at no charge by calling

(620) 275-4281. 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, 2009. We are a shareholder in AgVantis, along with all other AgVantis customers. In addition, we purchased payroll and other human resources services from AgBank during 2007. Farm Credit Foundations will be providing our payroll and human resource services beginning January 1, 2008.

ECONOMIC OVERVIEW

Over the past year, economic conditions for our customers were generally good. Crop yields recovered from a multi-year drought, yielding above average crops. Coupled with this were the best crop prices in history. Demand for corn and grain sorghum was driven by ethanol production, as well as global demand. As a result, acreage formerly used for wheat production was converted to corn and grain sorghum production to obtain starch. Market conditions for cattlemen have been mixed through the supply chain. Cow/calf producers have experienced good returns due to higher cattle prices; however, returns to fat cattle have been below normal due to high feed costs. Milk prices were very favorable in 2007 and promoted an increase in dairy infrastructure and investment. Due to these favorable economic conditions, land values have increased briskly in 2007. Land values were up approximately 12% to 15% in 2007. The outlook for the future for agriculture is bright; however, the overall economy appears to be headed towards a slowdown.

LOAN PORTFOLIO

Total loan volume was \$403,750 at December 31, 2007, an increase of \$4,197, or 1.05%, from loans at December 31, 2006 of \$399,553, and \$9,119, or 2.31%, from loans at December 31, 2005 of \$394,631. The increase in loans was due to an overall increase in demand. The types of loans outstanding at December 31 are reflected in the following table.

	2007		2006		2005	
	Volume	Percent	Volume	Percent	Volume	Percent
Real estate mortgage	\$ 225,401	55.83%	\$ 225,810	56.51%	\$ 239,236	60.62%
Production and intermediate-term Agribusiness:	142,206	35.22%	147,620	36.95%	140,784	35.68%
Loans to cooperatives	2,662	0.66%	4,984	1.25%	2,302	0.58%
Process and marketing	28,568	7.08%	12,137	3.04%	3,184	0.81%
Farm related business	4,501	1.11%	8,772	2.19%	8,918	2.26%
Rural residential real estate	412	0.10%	230	0.06%	207	0.05%
Total	\$ 403,750	100.00%	\$ 399,553	100.00%	\$ 394,631	100.00%

In 2007, real estate mortgage volume decreased to \$225,401, compared with \$225,810 at year-end 2006, primarily due to a large participation purchased interest that was misclassified as real estate mortgage and was reclassified to processing and marketing. These long-term mortgage loans are primarily used to purchase, refinance or improve real estate. These loans have maturities ranging from five years 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 be made only in amounts 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 Financial Statements for more detail.

The production and intermediate-term volume decreased 3.67% to \$142,206 compared with 2006 loan volume of \$147,620 primarily due to a decrease in demand. 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.

The majority of agribusiness loan volume was purchased interests in loans. The increase in process and marketing volume during 2007 was primarily due to a large participation purchased interest that was reclassified from real estate mortgage to processing and marketing. The decrease in farm related business volume was due to a payoff of one large borrower.

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.

	2007	2006	2005
Participations purchased	\$ 105,255	\$ 103,699	\$ 90,381
Participations sold	\$ 49,712	\$ 47,315	\$ 39,055

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

	2007	2006	2005
Finney	13.11%	13.64%	13.50%
Hamilton	8.43%	7.45%	7.75%
Stanton	7.90%	8.72%	8.63%
Gray	5.91%	5.15%	5.20%
Stevens	5.11%	5.36%	4.24%
Grant	4.96%	4.67%	5.68%
Ford	4.94%	5.10%	4.85%
Greeley	4.09%	4.30%	5.61%
Seward	3.85%	3.24%	3.79%
Kearny	3.69%	2.76%	3.01%
Wichita	3.52%	3.75%	4.16%
Scott	3.00%	3.42%	3.49%
Morton	2.61%	3.07%	3.47%
Meade	1.89%	1.82%	1.89%
Haskell	1.55%	1.64%	1.98%
Clark	1.20%	1.38%	1.20%
Lane	0.39%	0.24%	0.29%
Other	23.85%	24.29%	21.26%
Total	100.00%	100.00%	100.00%

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.

	2007	2006	2005
Cash grains	47.72%	42.09%	44.17%
Cattle	24.88%	29.63%	31.33%
Dairy	15.44%	15.04%	14.51%
Ethanol	3.31%	1.17%	-
Hay crops	2.58%	2.34%	3.03%
Other	6.07%	9.73%	6.96%
Total	100.00%	100.00%	100.00%

Our loan portfolio contains a concentration of cash grain and cattle 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.

Small loans (less than \$250 thousand) accounted for 28.60% of loan volume at December 31, 2007. Credit risk on small loans, in many instances, is also reduced by non-farm income sources. The table below details the loan principal by dollar size.

	December 31, 2007	
(Range in thousands)	Amount outstanding	Number of loans
\$1 - \$250	\$ 115,459	1,599
\$251 - \$500	54,195	158
\$501 - \$1,000	60,896	85
\$1,001 - \$5,000	131,830	59
\$5,001 - \$25,000	41,370	5
Total	\$ 403,750	1,906

Approximately 20% of our loan volume is attributable to 10 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 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, 2007.

	Less than 1 year	1 – 3 years	3 – 5 years	Over 5 years	Total
Commitments to extend credit	\$ 166,349	\$ 16,909	\$ 8,183	\$ 4,639	\$ 196,080
Standby letters of credit	1,269	10	-	-	1,279
Total commitments	\$ 167,618	\$ 16,919	\$ 8,183	\$ 4,639	\$ 197,359

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 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.

	2007	2006	2005
Nonaccrual loans:			
Real estate mortgage	\$ 5	\$ 1,181	\$ 3,799
Production and intermediate-term	–	531	3,137
Agribusiness	–	–	1,677
Total nonaccrual loans	5	1,712	8,613
Accruing restructured loans:			
Real estate mortgage	–	92	95
Total impaired loans	5	1,804	8,708
Other property owned	2,750	2,519	–
Total high risk assets	\$ 2,755	\$ 4,323	\$ 8,708
Nonaccrual loans to total loans	–	0.43%	2.18%
High risk assets to total loans	0.68%	1.08%	2.21%
High risk assets to total shareholders' equity	2.42%	3.96%	8.53%

We had no loans 90 days past due still accruing interest for the years presented.

Total high risk assets decreased \$1,568, or 36.27%, to \$2,755 at December 31, 2007 compared with year-end 2006. High risk asset volume is anticipated to decrease in the future. The dry mill ethanol and by-product manufacturing plant carried as other property owned is expected to sell before year-end 2008.

Nonaccrual loans represent all loans where there is a reasonable doubt as to collection of principal and/or interest. Nonaccrual volume decreased \$1,707 compared with December 31, 2006 due largely to the transfer of three loans to accrual status because of the borrower's capacity to make successive on-time payments. The following table provides additional information on nonaccrual loans as of December 31.

	2007	2006	2005
Nonaccrual loans current as to principal and interest	\$ 5	\$ 1,508	\$ 1,254
Cash basis nonaccrual loans	\$ –	\$ 12	\$ 12

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

Other property owned is real or personal property that has been acquired through foreclosure, deed in lieu of foreclosure or other means. We had other property owned of \$2,750 at December 31, 2007, compared to \$2,519 at December 31, 2006 and none at December 31, 2005. Other property owned at December 31, 2007 and 2006 consisted of one dry mill ethanol and by-product manufacturing plant. The \$231 increase in other property owned consisted entirely of improvements made to the facility.

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.

	2007	2006	2005
Acceptable	87.71%	88.13%	88.38%
OAEM	7.71%	7.12%	7.09%
Substandard	4.58%	4.75%	4.53%
Total	100.00%	100.00%	100.00%

During 2007, overall credit quality improved. Loans classified as "Acceptable" and "OAEM" were 95.42% at December 31, 2007 and 95.25% at December 31, 2006. 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 0.90% at December 31, 2007, compared with 2.27% at December 31, 2006.

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.

	2007	2006	2005
Balance at beginning of year	\$ 1,497	\$ 2,926	\$ 2,190
Charge-offs:			
Production and intermediate-term	11	–	252
Agribusiness	–	–	3,202
Total charge-offs	11	–	3,454
Recoveries:			
Production and intermediate-term	2	260	9
Agribusiness	448	997	–
Total recoveries	450	1,257	9
Net (recoveries)/charge-offs	(439)	(1,257)	3,445
Provision for loan losses/(Loan loss reversal)	521	(2,686)	4,181
Balance at December 31	\$ 2,457	\$ 1,497	\$ 2,926
Net (recoveries)/charge-offs to average net loans	(0.11%)	(0.32%)	0.88%

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

	2007	2006	2005
Real estate mortgage	\$ 284	\$ 267	\$ 413
Production and intermediate-term	1,817	1,191	1,229
Agribusiness	356	39	1,284
Total	\$ 2,457	\$ 1,497	\$ 2,926

The allowance for loan losses increased \$960 from December 31, 2006, to \$2,457 at December 31, 2007. The increase in allowance for loan losses was due to the provision for loan losses totaling \$521 that was recorded as a result of increased risk exposure on certain loans and net recoveries of \$439. Overall, charge-off activity remains very low relative to the size of our loan portfolio. 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.

	2007	2006	2005
Allowance as a percentage of:			
Loans	0.61%	0.37%	0.74%
Impaired loans	49,140.00%	82.98%	33.60%
Nonaccrual loans	49,140.00%	87.44%	33.97%

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. As a key part of our Mission Statement to be the “Agricultural lender of choice for farmers, ranchers and agricultural firms in Southwest Kansas” we are, “Helping to develop agriculture and the rural economy further through Young, Beginning and Small Farmer lending.” 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.

	2007	2006	2005	USDA
Young	15.46%	16.22%	16.00%	7.05%
Beginning	15.97%	15.14%	14.29%	22.19%
Small	41.56%	45.69%	46.40%	84.04%

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

- 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.

We annually set new targets for YBS borrowers measured numerically and in total volume (measured by loan commitments). For 2007 projected targets and actual results for YBS new loan numbers and volume are reflected in the chart below.

New Loans	Projected Number	Actual Number	Projected Volume	Actual Volume
Young	18	32	\$ 1,850	\$ 8,570
Beginning	23	40	2,000	10,161
Small	40	53	4,050	5,327
Totals	81	125	\$ 7,900	\$ 24,058

The following targets have been set for YBS new loans for 2008.

New Loans	Projected Number	Projected Volume
Young	20	\$ 2,100
Beginning	23	1,800
Small	41	4,200
Totals	84	\$ 8,100

We also participate with other commercial lenders and System institutions on loans to borrowers who would meet one or any combination of the YBS criterion.

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, which include:

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

We extensively market our lending territory for YBS borrowers through radio advertising, 4-H and FFA sponsorships, scholarships and loans for project animals, contacts with the Ag-Departments in the three area community colleges and area county fairs, premium sales, high school activities, personal loan officer contacts, etc. Brochures regarding our YBS Program are also located in each Branch office and distributed throughout the lending territory at local dealerships, Farm Service Agency (FSA) offices, extension offices, realtor offices, etc. We also sponsor statewide activities in conjunction with other Farm Credit offices such as Women Managing the Farm Seminars, 4-H Key Awards, Kansas Livestock Association (KLA) Field Days, KLA Breakfast and Cowboy College at their annual meeting and Fort Hays State Scholarships.

Finally, we offer special interest rates, terms and conditions incentives on our lending products to assist qualifying YBS borrowers. However, we ensure that credit and services offered to our YBS farmers and ranchers are provided in a safe and sound manner and within our and the YBS borrower's risk-bearing capacity. We utilize loan underwriting standards, loan guarantee programs, breaks on fees/ loan charges and etc. to accomplish this goal. 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 (including 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. Lending limits are established for individual loan size, commodity, and special lending programs. We have adopted an individual loan size maximum of 15% 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 implemented a two-dimensional risk rating process in 2005. With this process, each retail loan is assigned a probability of default rating (1-14 scale) indicating the likelihood of a borrower defaulting in the next twelve months and a collateral rating which is based on an estimate of the anticipated loss on each loan, should the borrower default in the next 12 months. This process is also utilized in loan and portfolio management processes which include allowance for loan losses estimates. The process provides more risk granularity, particularly related to acceptable loans, than classifications under the UCS.

RESULTS OF OPERATIONS

Earnings Summary

In 2007, we recorded net income of \$9,645, compared with \$11,616 in 2006, and \$4,491 in 2005. The decrease in 2007 was primarily due to a provision for loan loss that was recorded in 2007, as compared to a loan loss reversal in 2006. The following table presents the changes in the significant components of net income from the previous year.

	2007 vs. 2006	2006 vs. 2005
Net income, prior year	\$ 11,616	\$ 4,491
Increase/(Decrease) from changes in:		
Interest income	1,379	4,389
Interest expense	(577)	(3,889)
Net interest income	802	500
Provision for loan losses	(3,207)	6,867
Noninterest income	496	426
Noninterest expense	79	(657)
Provision for income taxes	(141)	(11)
Total (decrease)/increase in net income	(1,971)	7,125
Net income, current year	\$ 9,645	\$ 11,616

Net Interest Income

Net interest income for 2007 was \$12,688 compared with \$11,886 for 2006 and \$11,386 for 2005. The table below provides an analysis of the individual components of the change in net interest income during 2007 and 2006.

	2007 vs. 2006	2006 vs. 2005
Net interest income, prior year	\$ 11,886	\$ 11,386
Increase/(Decrease) in net interest income from changes in:		
Interest rates earned	771	3,749
Interest rates paid	(555)	(3,734)
Volume of accruing assets/interest bearing liabilities	521	333
Interest income on nonaccrual loans	65	152
Increase in net interest income	802	500
Net interest income, current year	\$ 12,688	\$ 11,886

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

	Year Ended December 31		
	2007	2006	2005
Net interest margin	3.13%	2.99%	2.88%
Interest rate on:			
Average loan volume	7.26%	7.09%	6.13%
Average debt	5.07%	4.82%	3.65%
Interest rate spread	2.19%	2.27%	2.48%

The decrease in interest rate spread resulted from a 17 basis point increase in interest rate on average loan volume and a 25 basis point increase in interest rates on average debt. The increase in net interest margin was due to higher earnings on own capital.

Provision for Loan Losses/(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 net provision for loan losses of \$521 for the year ended December 31, 2007, compared with a net loan loss reversal of \$2,686 in 2006 and a net provision for loan losses of \$4,181 in 2005. The provision for loan losses recorded during 2007 was primarily due to increased risk exposure on certain loans. The 2005 provision for loan loss that was booked in anticipation of an expected loss did not occur and was reversed in 2006.

Noninterest Income

For the year ended December 31, 2007, we recorded noninterest income of \$3,986, compared with \$3,490 in 2006 and \$3,064 in 2005. 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		
	2007	2006	2005
Cash patronage	\$ 3,060	\$ 2,088	\$ 1,737
Stock patronage	–	908	815
Total patronage from AgBank to the Association	\$ 3,060	\$ 2,996	\$ 2,552

Noninterest income also includes loan fees, financially related services income and other noninterest income. Financially related services in 2007 were \$656, an increase of \$417, from 2006, primarily due to increased crop insurance sales resulting from above average crops and high commodity prices.

Noninterest Expense

Noninterest expense for the year ended December 31, 2007, decreased \$79, or 1.24%, to \$6,291 compared with 2006. Significant components of noninterest expense for each of the three years ended December 31 are compared in the following table.

	Year Ended December 31				
	2007	2006	2005	Percent of Change	
				2007/2006	2006/2005
Salaries & employee benefits	\$ 3,543	\$ 3,583	\$ 3,302	(1.12%)	8.51%
Occupancy & equipment	430	384	381	11.98%	0.79%
Purchased services from AgVantis	353	374	345	(5.61%)	8.41%
Purchased services from AgBank	90	121	100	(25.62%)	21.00%
Supervisory & examination costs	169	176	170	(3.98%)	3.53%
Other	1,214	1,250	1,122	(2.88%)	11.41%
Total operating expense	5,799	5,888	5,420	(1.51%)	8.63%
Gains on other property, owned, net	(118)	(119)	(10)	(0.84%)	(1,090%)
Farm Credit Insurance Fund premium	610	601	211	1.50%	184.83%
Financial Assistance Corporation debt assessment	–	–	92	–	(100.00%)
Total noninterest expense	\$ 6,291	\$ 6,370	\$ 5,713	(1.24%)	11.50%

For the year ended December 31, 2007, total operating expense decreased \$89, or 1.51%, compared to the year ended December 31, 2006 primarily due to a decrease in salaries and employee benefits. During 2007, the pension and postretirement plans were amended, which resulted in the immediate recognition of \$99 recorded as a decrease to salaries and employee benefits expense. Refer to Note 11 for more information. The decrease was primarily due to a reduction in purchased services from AgVantis and AgBank.

Occupancy and equipment increased due to increased depreciation expense related to a major remodeling project of the Garden City office. Insurance Fund premium increased \$9 to \$610 due to an increase in loan volume. Rates were 15 basis points in 2007 and 2006 as compared to 5 basis points in 2005. The debt to the Financial Assistance Corporation matured in June 2005. Note 12 of the Notes to Financial Statements provides more details related to the Financial Assistance Corporation.

Provision for Income Taxes/Benefit from Income Taxes

We recorded \$217 in provision for income taxes during 2007, compared with \$76 in 2006 and \$65 in 2005. The increase was primarily due to decreasing our deferred tax asset with an increase in the deferred tax valuation allowance.

LIQUIDITY RISK MANAGEMENT

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, maximize debt reduction and liquidate nonearning assets. Our direct loan with AgBank, cash on hand and loan repayments provide adequate liquidity to fund our on-going operations and other commitments. 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, 2008 in accordance with normal business practices. The annual average principal balances of the note payable to AgBank were \$313,550 in 2007, \$315,235 in 2006 and \$312,492 in 2005.

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.

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.

For ESMP purposes, the weighted average remaining term of our net worth in total is limited to a maximum of 2.5 years. Our ESMP commitment balance and the average interest rate as of December 31, 2007 in the various maturities are reflected below:

	Balance	Average Rate
Maturing in 1 year or less	\$ 5,500	4.16%
Maturing in 1 to 3 years	5,400	4.25%
Total	\$ 10,900	4.20%

Funds Management

We offer variable, fixed, adjustable prime-based and LIBOR-based rate loans to borrowers. Our Board of Directors 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, 2007 totaled \$113,873, compared with \$109,212 at December 31, 2006 and \$102,043 at December 31, 2005. 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.

	2007	2006	2005
Debt to shareholders' equity	2.89:1	2.99:1	3.15:1
Shareholders' equity as a percent of loans	28.20%	27.33%	25.86%
Shareholders' equity as a percent of assets	25.68%	25.05%	24.10%

Debt to shareholders' equity decreased and shareholders' equity as a percent of loans and of total assets increased from 2006 to 2007 primarily due to a decrease in net income and an increase in patronage distributions declared coupled with a modest increase in loan volume.

Retained Earnings

Our retained earnings increased \$4,645 to \$112,627 at December 31, 2007 from \$107,982 at December 31, 2006. The increase was a result of net income of \$9,645, partially offset by \$5,000 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 \$4,000 in 2007, \$2,750 in 2006 and \$2,500 in 2005.

Stock

Our total stock decreased \$56 to \$1,174 at December 31, 2007, from \$1,230 at December 31, 2006. The decrease was due to \$186 of stock retirements, partially offset by \$130 issuances. At the beginning of 2006, we required a stock investment of the lesser of one thousand dollars or 2.00% of the amount of each loan. On June 1, 2006, we implemented a Borrower Level Stock Program as approved by the Board of Directors. This program allows stock to be assigned to a borrower instead of a loan, which reduces the stock requirements for borrowers with multiple loans. The current stock requirement for each shareholder is the lesser of one thousand dollars or 2.00% of the collective total balance of each shareholder's loan(s). During 2007, loan level stock of \$181 was transferred to borrower level stock as a result of implementation of this program.

Accumulated Other Comprehensive Income and Losses (AOCI)

Certain employees participate in a non-qualified Defined Benefit Pension Restoration Plan (Plan). On December 31, 2007, we adopted SFAS No. 158 as it relates to the Plan which requires recognition of the Plan's unamortized actuarial gains and losses and prior service costs or credits as a liability with an offsetting adjustment to AOCI. We recorded a \$72 gain to AOCI as a result of the application of SFAS No.158 – Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans.

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.

	2007	2006	2005	Regulatory Minimum
Permanent capital ratio	25.62%	23.47%	22.19%	7.00%
Total surplus ratio	25.38%	23.21%	21.83%	7.00%
Core surplus ratio	22.46%	21.27%	20.01%	3.50%

As of December 31, 2007, we exceeded the regulatory minimum capital ratios and are expected to do so throughout 2008. 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, 2007, we have exceeded 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.

REGULATORY MATTERS

As of December 31, 2007, 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 and 75 calendar days for our quarterly and 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 are effective with the year-end 2007 annual report. On July 12, 2007, the FCA Board adopted a proposed rule that would allow System institutions 90 days after the end of the year to prepare and distribute paper copies of their annual reports to shareholders. Each institution would be required to file electronic copies of the reports with FCA and post the report to its website within 75 days.

GOVERNANCE

Board of Directors

We are governed by a 10 member board that oversees the management of our Association. Of these directors, nine 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 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 three members. During 2007, ten 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 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 assisting management with the administration of employee and Board compensation. The Committee consists of three directors appointed by the Board.

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 have implemented 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 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 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 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.

Consolidated Statement of Condition

(Dollars in Thousands)

	December 31		
	2007	2006	2005
ASSETS			
Loans	\$ 403,750	\$ 399,553	\$ 394,631
Less allowance for loan losses	2,457	1,497	2,926
Net loans	401,293	398,056	391,705
Cash	4,784	3,299	1,731
Accrued interest receivable	8,468	9,155	8,481
Investment in U.S. AgBank, FCB	17,705	17,705	16,797
Premises and equipment, net	1,833	1,877	1,558
Other property owned	2,750	2,519	-
Prepaid benefit expense	647	975	1,073
Deferred tax asset	57	230	301
Other assets	5,980	2,150	1,778
Total assets	\$ 443,517	\$ 435,966	\$ 423,424
LIABILITIES			
Note payable to U.S. AgBank, FCB	\$ 304,264	\$ 308,125	\$ 305,653
Advance conditional payments	8,353	3,678	4,464
Accrued interest payable	8,726	8,421	6,769
Patronage distributions payable	5,000	4,000	2,750
Accrued liability benefits	245	378	352
Other liabilities	3,056	2,152	1,393
Total liabilities	329,644	326,754	321,381
Commitments and Contingencies (See Note 15)			
SHAREHOLDERS' EQUITY			
Protected borrower stock	89	92	102
Capital stock	1,085	1,138	1,575
Unallocated retained earnings	112,627	107,982	100,366
Accumulated other comprehensive income	72	-	-
Total shareholders' equity	113,873	109,212	102,043
Total liabilities and shareholders' equity	\$ 443,517	\$ 435,966	\$ 423,424

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

Consolidated Statement of Income

(Dollars in Thousands)

	For the Year Ended December 31		
	2007	2006	2005
INTEREST INCOME			
Loans	\$ 29,588	\$ 28,209	\$ 23,820
Total interest income	29,588	28,209	23,820
INTEREST EXPENSE			
Note payable to U.S. AgBank, FCB	16,658	16,179	12,355
Other	242	144	79
Total interest expense	16,900	16,323	12,434
Net interest income	12,688	11,886	11,386
Provision for loan losses/(Loan loss reversal)	521	(2,686)	4,181
Net interest income after provision for loan losses/(loan loss reversal)	12,167	14,572	7,205
NONINTEREST INCOME			
Financially related services income	656	239	422
Loan fees	196	215	43
Patronage distribution from U.S. AgBank, FCB	3,060	2,996	2,552
Other noninterest income	74	40	47
Total noninterest income	3,986	3,490	3,064
NONINTEREST EXPENSE			
Salaries and employee benefits	3,543	3,583	3,302
Occupancy and equipment	430	384	381
Purchased services from AgVantis, Inc.	353	374	345
Purchased services from U.S. AgBank, FCB	90	121	100
Gains on other property owned, net	(118)	(119)	(10)
Farm Credit Insurance Fund premium	610	601	211
Financial Assistance Corporation debt assessment	-	-	92
Supervisory and examination costs	169	176	170
Other noninterest expense	1,214	1,250	1,122
Total noninterest expense	6,291	6,370	5,713
Income before income taxes	9,862	11,692	4,556
Provision for income taxes	217	76	65
Net income	\$ 9,645	\$ 11,616	\$ 4,491

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	Accumulated Other Comprehensive Income	Total Shareholders' Equity
Balance at December 31, 2004	\$ 124	\$ 1,606	\$ 98,625	\$ -	\$ 100,355
Net income			4,491		4,491
Stock issued	-	249			249
Stock retired	(22)	(280)			(302)
Patronage distributions: Cash			(2,750)		(2,750)
Balance at December 31, 2005	102	1,575	100,366	-	102,043
Net income			11,616		11,616
Stock converted	(1)	1			-
Stock issued	-	207			207
Stock retired	(9)	(645)			(654)
Patronage distributions: Cash			(4,000)		(4,000)
Balance at December 31, 2006	92	1,138	107,982	-	109,212
Net income			9,645		9,645
Adjustment to initially apply SFAS No. 158				72	72
Stock issued	-	130			130
Stock retired	(3)	(183)			(186)
Patronage Distributions: Cash			(5,000)		(5,000)
Balance at December 31, 2007	\$ 89	\$ 1,085	\$ 112,627	\$ 72	\$ 113,873

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		
	2007	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	\$ 9,645	\$ 11,616	\$ 4,491
Adjustments to reconcile net income to net cash provided by/(used in) operating activities:			
Depreciation	242	205	176
Provision for/(Loan loss reversal) loan losses	521	(2,686)	4,181
Patronage stock from U.S. AgBank, FCB	-	(908)	(815)
Gains on sales of premises and equipment	(23)	-	-
Gains on sales of other property owned	-	(72)	(9)
Change in assets and liabilities:			
Decrease/(Increase) in deferred tax asset	173	71	(95)
Decrease/(Increase) in accrued interest receivable	687	(674)	(727)
Decrease/(Increase) in prepaid benefit expense	328	98	(290)
Increase in other assets	(3,830)	(372)	(362)
Increase in accrued interest payable	305	1,652	1,898
(Decrease)/Increase in accrued liability benefits	(61)	26	28
Increase/(Decrease) in other liabilities	904	759	(685)
Total adjustments	(754)	(1,901)	3,300
Net cash provided by operating activities	8,891	9,715	7,791
CASH FLOWS FROM INVESTING ACTIVITIES:			
Increase in loans, net	(3,758)	(6,414)	(2,534)
Expenditures for premises and equipment, net	(175)	(524)	(754)
Expenditures for other property owned	(231)	-	-
Proceeds from sales of other property owned	-	302	183
Net cash used in investing activities	(4,164)	(6,636)	(3,105)
CASH FLOWS FROM FINANCING ACTIVITIES:			
(Repayment of)/Net draw on note payable to U.S. AgBank, FCB	(3,861)	2,472	(1,244)
Increase/(Decrease) in advance conditional payments	4,675	(786)	(771)
Protected borrower stock retired	(3)	(9)	(22)
Capital stock retired	(183)	(645)	(280)
Capital stock issued	130	207	249
Cash patronage distributions paid	(4,000)	(2,750)	(2,500)
Net cash used in financing activities	(3,242)	(1,511)	(4,568)
Net increase in cash	1,485	1,568	117
Cash at beginning of year	3,299	1,731	1,614
Cash at end of year	\$ 4,784	\$ 3,299	\$ 1,731
SUPPLEMENTAL CASH INFORMATION:			
Cash paid/(received) during the year for:			
Interest	\$ 16,595	\$ 14,671	\$ 10,536
Income taxes	\$ (147)	\$ 149	\$ 145
SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:			
Loans transferred to other property owned	\$ -	\$ 2,749	\$ -
Protected borrower stock converted to capital stock	\$ -	\$ 1	\$ -
Net (recoveries)/charge-offs	\$ (439)	\$ (1,257)	\$ 3,445
Patronage distributions payable	\$ 5,000	\$ 4,000	\$ 2,750
Change in other accumulated comprehensive income	\$ 72	\$ -	\$ -

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

NOTES TO FINANCIAL STATEMENTS

(Dollars in Thousands, Except as Noted)

NOTE 1 – ORGANIZATION AND OPERATIONS

- A. Organization: Farm Credit of Southwest Kansas, ACA and its subsidiaries, Farm Credit of Southwest Kansas, FLCA, (Federal Land Credit Association (FLCA)) and Farm Credit of Southwest Kansas, 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 Clark, Finney, Ford, Grant, Gray, Greeley, Hamilton, Haskell, Kearny, Lane, Meade, Morton, Scott, Seward, Stanton, Stevens and Wichita in the state of Kansas.

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, 2007, 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, 2007, the District consisted of AgBank, 26 Agricultural Credit Association (ACA) parent companies, which each have two wholly owned subsidiaries, (a FLCA and a PCA), three 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 is required to pay premiums into the Insurance Fund based on its annual average loan principal outstanding until the monies in the Insurance Fund reach the “secure base amount,” which is defined in the Farm Credit Act as 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. AgBank passes this premium expense through to the Association based on the Association’s annual average loan volume.

- 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 and multi-peril crop and crop hail insurance.

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 District's Annual Report to Shareholders (District's Annual Report). The District's Annual Report is available on its web site, 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. 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 financial statements and accompanying notes. Significant estimates are discussed in these footnotes as applicable. Actual results may differ from these estimates.

The consolidated financial statements include the accounts of Farm Credit of Southwest Kansas, FLCA and Farm Credit of Southwest Kansas, 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 less unearned income. Interest on loans is accrued and credited to interest income based upon the daily principal amount outstanding.

Impaired loans are loans for which it is probable that not all principal and interest will be collected according to the contractual terms of the loan. Impaired loans include nonaccrual loans, restructured loans, and loans past due 90 days or more and still accruing interest. 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.

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.

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 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. Other Property Owned: Other property owned, consisting of real and personal property acquired through a collection action, is recorded at fair value less estimated selling costs upon acquisition. Revised estimates to the fair value less cost to sell are reported as adjustments to the carrying amount of the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Income and expenses from operations and carrying value adjustments are included in gains on other property owned, net.
- E. 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.
- F. 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.
- G. 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.
- H. Employee benefit plans: Substantially all employees of the Association participated 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 will be distributed from the Pension Plan and may be transferred to the 401(k) Plan. Substantially all employees also participate in 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 Ninth District Retiree Medical Plan. Postretirement benefits other than pensions are provided to eligible retired employees of the Association. Prior to 2007, substantially all employees could become eligible for these benefits and the anticipated costs of these benefits were accrued during the period of the employee's active service. During 2007, the plan was frozen and amended to only continue benefits for current retirees.
- I. 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 tax. 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 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 pre-1993 patronage distributions received from AgBank when 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.

- J. 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.
- K. Accumulated Other Comprehensive Income: Accumulated other comprehensive income refers to revenue, expenses, gains and losses that under GAAP are recorded as an element of shareholders' equity but are excluded from net income. The Association records accumulated other comprehensive income associated with the liability under the Pension Restoration Plan.
- L. Recently Issued Accounting Pronouncements: On September 30, 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 158 – Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans. The Standard requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and recognize changes in that funded status in the year in which the changes occur through other comprehensive income. The Standard further requires the determination of the fair value of plan assets at year-end and recognition of actuarial gains and losses, prior service costs or credits, and transition assets and obligations as a component of accumulated other comprehensive income for the fiscal year ended December 31, 2007. In addition, this Standard requires that the funded status of a plan be measured as of the date of the year-end financial statements. Currently, the Association uses a measurement date of September 30. The requirement to measure the funded status as of the fiscal year-end is effective for the Association for the fiscal year ended after December 31, 2008.

In September 2006, the FASB also issued Statement of Financial Accounting Standards No. 157 – Fair Value Measurements. This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. As a result, there is now a common definition of fair value to be used throughout generally accepted accounting principles. The FASB believes that the new standard will make the measurement of fair value more consistent and comparable and improve disclosures about those measures. This Statement clarifies that the term fair value is intended to mean a market-based measure, not an entity-specific measure. In measuring fair value for a financial statement item, the Statement sets forth a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The highest priority is given to quoted prices in active markets and the lowest priority to unobservable inputs. Additional disclosure requirements will be required for the lowest priority level. The Statement became effective January 1, 2008. The Association is still assessing the impact on our financial statements.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159 – Fair Value Option for Financial Assets and Financial Liabilities. The Standard permits entities to choose on an instrument-by-instrument basis, at specified election dates, to measure financial assets and liabilities and certain other items at fair value (the “fair value option”). Unrealized gains and losses on items for which the fair value option has been elected must be reported in earnings at each subsequent reporting date. Upfront costs and fees related to items for which the fair value option is elected shall be recognized in earnings as incurred and not deferred. This Standard became effective January 1, 2008. The Association has not made any elections under the fair value option; thus there is no impact of the adoption of the Standard.

NOTE 3 – LOANS AND ALLOWANCE FOR LOAN LOSSES

A summary of loans follows.

	December 31		
	2007	2006	2005
Real estate mortgage	\$ 225,401	\$ 225,810	\$ 239,236
Production and intermediate-term	142,206	147,620	140,784
Agribusiness:			
Loans to cooperatives	2,662	4,984	2,302
Process and marketing	28,568	12,137	3,184
Farm related business	4,501	8,772	8,918
Rural residential real estate	412	230	207
Total	\$ 403,750	\$ 399,553	\$ 394,631

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					
	2007		2006		2005	
	Amount	Percent	Amount	Percent	Amount	Percent
Cash grains	\$ 192,670	47.72%	\$ 168,172	42.09%	\$ 174,309	44.17%
Cattle	100,453	24.88%	118,387	29.63%	123,638	31.33%
Dairy	62,339	15.44%	60,093	15.04%	57,261	14.51%
Ethanol	13,364	3.31%	4,675	1.17%	-	-
Hay crops	10,416	2.58%	9,350	2.34%	11,957	3.03%
Other	24,508	6.07%	38,876	9.73%	27,466	6.96%
Total	\$ 403,750	100.00%	\$ 399,553	100.00%	\$ 394,631	100.00%

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		
	2007	2006	2005
Nonaccrual:			
Current as to principal and interest	\$ 5	\$ 1,508	\$ 1,254
Past due	-	204	7,359
Total nonaccrual	5	1,712	8,613
Accrual:			
Restructured	-	92	95
Total impaired loans	\$ 5	\$ 1,804	\$ 8,708

No loans were accruing 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, 2007.

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		
	2007	2006	2005
Interest income recognized on nonaccrual loans	\$ 65	\$ 152	\$ 200
Interest income on impaired accrual loans	187	59	94
Interest income recognized on impaired loans	\$ 252	\$ 211	\$ 294
Average impaired loans	\$ 2,369	\$ 3,608	\$ 7,958

The following table presents information concerning impaired loans.

	December 31		
	2007	2006	2005
Impaired loans with related allowance	\$ -	\$ -	\$ 1,531
Impaired loans with no related allowance	5	1,804	7,177
Total impaired loans	\$ 5	\$ 1,804	\$ 8,708
Allowance on impaired loans	\$ -	\$ -	\$ 1,168

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		
	2007	2006	2005
Interest income which would have been recognized under the original loan terms	\$ 523	\$ 1,029	\$ 1,225
Less: interest income recognized	126	206	260
Interest income not recognized	\$ 397	\$ 823	\$ 965

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

	2007	2006	2005
Balance at beginning of year	\$ 1,497	\$ 2,926	\$ 2,190
Charge-offs:			
Production and intermediate-term	11	-	252
Agribusiness	-	-	3,202
Total charge-offs	11	-	3,454
Recoveries:			
Production and intermediate-term	2	260	9
Agribusiness	448	997	-
Total recoveries	450	1,257	9
Net (recoveries)/charge-offs	(439)	(1,257)	3,445
Provision for loan losses(Loan loss reversal)	521	(2,686)	4,181
Balance at December 31	\$ 2,457	\$ 1,497	\$ 2,926
Net (recoveries)/charge-offs to average net loans	(0.11%)	(0.32%)	0.88%

A breakdown of the allowance for loan losses follows.

	2007		2006		2005	
	Amount	Percent	Amount	Percent	Amount	Percent
Real estate mortgage	\$ 284	11.56%	\$ 267	17.84%	\$ 413	14.12%
Production and intermediate-term	1,817	73.95%	1,191	79.56%	1,229	42.00%
Agribusiness	356	14.49%	39	2.60%	1,284	43.88%
Total	\$ 2,457	100.00%	\$ 1,497	100.00%	\$ 2,926	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.

	December 31		
	2007	2006	2005
Land	\$ 196	\$ 196	\$ 196
Buildings and leasehold improvements	2,693	2,621	1,905
Furniture, equipment and automobiles	1,453	1,563	1,331
Construction in progress	–	–	578
	4,342	4,380	4,010
Less: accumulated depreciation	2,509	2,503	2,452
Total	\$ 1,833	\$ 1,877	\$ 1,558

NOTE 6 – OTHER PROPERTY OWNED

Gains on other property owned, net as reflected on the Consolidated Statement of Income consists of the following.

	December 31		
	2007	2006	2005
Gains on sale, net	\$ –	\$ 72	\$ 9
Operating income, net	118	47	1
Gains on other property owned, net	\$ 118	\$ 119	\$ 10

NOTE 7 – 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 \$360 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, 2007. 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 5.07 percent for the year ended December 31, 2007. The line of credit expires on April 30, 2008, 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.

	2007	2006	2005
Committed funds	\$ 10,900	\$ 29,900	\$ 43,700
Average rates	4.20%	4.35%	3.89%

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, 2007, the Association's notes payable are within the specified limitations.

NOTE 8 – 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. The Board of Directors approved a Borrower Level Stock program, which changed the stock requirement from the lesser of one thousand dollars or 2.00 percent of the borrower's loan balance to the lesser of one thousand dollars or 2.00 percent of the aggregate face amount of the borrower's note(s). The Borrower Level Stock program was implemented June 1, 2006.

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 the FCA that, if undertaken, could have a direct material effect on the Association's financial statements. The Association is prohibited from reducing permanent capital by retiring stock or making certain other distributions to shareholders unless prescribed capital standards are met. 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, 2007, the

Association's permanent capital was 25.62 percent, core surplus was 22.46 percent and total surplus ratio was 25.38 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 Preferred Stock (Nonvoting, at-risk, no shares outstanding) - Represents Association retained earnings, dividends or patronage distributions allocated on or after October 6, 1988. This stock may also represent Class B or Class C Common Stock of a borrower which automatically converts to Class A two years after repayment of the loan in full. Retirement is at the sole discretion of the Board of Directors.
- Class B Common Stock (Voting, at-risk, 214,646 shares outstanding) - Issued on or after October 6, 1988, for farm and ranch loans. Retirement is at the sole discretion of the Board of Directors. If the Association is unable to retire Class B Common Stock, or if the borrower elects to keep his/her investment in the Association after repayment of the loan in full, the stock must be converted to Class A Preferred Stock within two years.
- Class C Common Stock (Nonvoting, at-risk, 2,340 shares outstanding) - Issued on or after October 6, 1988, for farm-related and rural home loans and to other persons or organizations who are eligible to borrow but are not eligible to hold voting stock. Retirement is at the sole discretion of the Board of Directors. Class C Common Stock may be issued at the discretion of the Association's Board to persons who sell participation interests in loans or leases to the Association. If the Association is unable to retire Class C Common Stock, or if the borrower elects to keep his/her investment in the Association after repayment of the loan in full, the stock must be converted to Class A Preferred Stock within two years.
- Class D Investor Stock (Nonvoting, at-risk, no shares outstanding, par value of one thousand dollars) - Available to outside parties.
- Class E Preferred Stock (Nonvoting, at-risk, no shares outstanding) - 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, 9,158 shares outstanding) - Issued prior to October 6, 1988, to borrowers entitled to vote. It must be retired at par value upon repayment of the loan unless the borrower elects to retain his/her investment in the Association. If so, the stock must be converted to Class G Common Stock within two years after loan repayment in full.
- Class G Common Stock (Nonvoting, protected, 8,629 shares outstanding) - Formerly participation certificates, this represents stock issued prior to October 6, 1988, to rural residence borrowers and others not eligible to vote. This stock may also represent Class F Common Stock of a borrower which automatically converts to Class G Common Stock two years after repayment of the loan in full. It must be retired at par value upon repayment of the loan unless the borrower elects to retain his/her investment in the Association.
- Class H Preferred Stock (Nonvoting, at-risk, no shares outstanding, par value of one dollar) - Issued to, and may be acquired only by owners of any class of Common Stock and holders of Class H Preferred Stock who are eligible to receive a dividend.

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 \$4,000 in 2007, \$2,750 in 2006 and \$2,500 in 2005. The Association declared a \$5,000 patronage distribution in 2007 to be paid in 2008.

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, to Class E Preferred Stock, then to Class H Preferred Stock, then Class A Preferred Stock; second, pro rata to all classes of common stock and investor stock. Any remaining assets of the Association after such distributions shall be distributed to holders of all classes of common stock, pro rata.

F. Accumulated Other Comprehensive Income

The Association reports accumulated other comprehensive income in its Consolidated Statement of Changes in Shareholders' Equity. As more fully described in Note 11, accumulated other comprehensive income results from the recognition of the Pension Restoration Plan's unamortized gains and losses and prior service costs or credits as a liability with an offsetting adjustment to accumulated other comprehensive income of \$72 as of December 31, 2007. There were no other items affecting accumulated other comprehensive income or loss.

NOTE 9 – PATRONAGE DISTRIBUTION FROM AGBANK

The patronage distribution from AgBank follows.

	Year Ended December 31		
	2007	2006	2005
Cash patronage	\$ 3,060	\$ 2,088	\$ 1,737
Stock allocation	–	908	815
Total patronage from AgBank	\$ 3,060	\$ 2,996	\$ 2,552

NOTE 10 – INCOME TAXES

The provision for income taxes follows.

	Year Ended December 31		
	2007	2006	2005
Current:			
Federal	\$ 35	\$ 5	\$ 131
State	9	1	29
Deferred:			
Federal	140	57	(77)
State	33	13	(18)
Total provision for income taxes	\$ 217	\$ 76	\$ 65

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

	Year Ended December 31		
	2007	2006	2005
Federal tax at statutory rate	\$ 3,354	\$ 3,975	\$ 1,549
State tax, net of federal benefit	27	10	7
Effect of nontaxable entity	(2,594)	(2,914)	(1,498)
Patronage	(854)	(446)	–
AgBank stock patronage dividend	–	(309)	(277)
Reduction in deferred tax asset - Patronage	167	(10)	–
Tax liability passed-thru to patrons	135	(226)	274
Other	(18)	(4)	10
Provision for income taxes	\$ 217	\$ 76	\$ 65

Deferred tax assets and liabilities result from the following.

	December 31		
	2007	2006	2005
Allowance for loan losses	\$ 492	\$ 393	\$ 785
Nonaccrual loan interest	475	400	338
Depreciation	5	15	29
Net gain on sale of fixed asset	8	8	8
Organizational costs	-	-	1
NOL carryover	154	154	154
Gross deferred tax assets	1,134	970	1,315
Deferred tax asset valuation allowance	(1,077)	(740)	(1,014)
Net deferred tax asset	\$ 57	\$ 230	\$ 301

The calculation of tax assets and liabilities involves various management estimates and assumptions as to the future taxable earnings. The Association recorded a valuation allowance of \$1,077 during 2007, \$740 during 2006 and \$1,014 during 2005. The Association will continue to evaluate the likely realization of these deferred tax assets and adjust the valuation allowance accordingly.

The Association adopted the provisions of the Financial Accounting Standards Board Interpretation No. 48, Accounting for Uncertainty in Income Taxes, on January 1, 2007. As a result of the implementation, the Association had no uncertain tax positions to be recognized upon adoption of FIN 48 during the first quarter of 2007 or during 2007. The tax years that remain open for federal and major state income tax jurisdictions are 2004 and forward.

NOTE 11 – 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. The Pension Plan required no funding during 2007; however, as a participant in the District's defined benefit plan, the Association funded \$212 for 2006 and \$541 for 2005, through its note payable to AgBank. Pension Plan expenses included in salaries and employee benefits expense were \$328 for 2007, \$310 for 2006, and \$251 for 2005. As of January 1, 2007, the Pension Plan was closed to new participants. During 2007, it was amended and then terminated for those participants with benefits only in the Account Balance provisions of the Pension Plan. The termination resulted in immediate expense recognition of \$55 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 District's 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 were income of \$115 and expense of \$41 for 2006 and \$39 for 2005. 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 \$154 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 participates in a District-wide non-qualified defined benefit Pension Restoration Plan that is unfunded. The purpose of the Pension Restoration Plan is to supplement a participant's benefits under the District's other retirement plans to the extent that such benefits are reduced by the limitations imposed by the Internal Revenue Code. Benefits payable under the Pension Restoration Plan are offset by the benefits payable from the Pension Plan. Pension Restoration Plan expenses included in salaries and employee benefits were income of \$3 for 2007 and expense of \$13 for 2006 and \$15 for 2005.

On December 31, 2007, the Association adopted SFAS No. 158 with regard to the Pension Restoration Plan, which requires the recognition of a plan's over-funded or under-funded status as an asset or liability with an offsetting adjustment to accumulated other comprehensive income. As the Pension Restoration Plan is unfunded and therefore does not hold assets, it will always be shown in an under-funded status as a liability. SFAS No. 158 requires the recognition of actuarial gains and losses, prior service costs or credits, and transition assets or obligations as a component of accumulated other comprehensive income. These amounts will be subsequently recognized as components of net periodic benefit costs. Further, actuarial gains and losses that arise in subsequent periods that are not initially recognized as a component of net periodic benefit cost will be recognized as a component of accumulated other comprehensive income. Those amounts will subsequently be recognized as a component of net periodic benefit cost as they are amortized during future periods.

The incremental effects of adopting the provisions of SFAS No. 158 on the Consolidated Statement of Condition at December 31, 2007 are presented in the following table. The adoption of SFAS No. 158 had no effect on the Consolidated Statement of Income for the year ended December 31, 2007.

	Before Application of SFAS No. 158	Adjustments	After Application of SFAS No. 158
Other liabilities	\$ 73	\$ (72)	\$ 1
Accumulated other comprehensive income	\$ -	\$ 72	\$ 72

The estimated net actuarial gain and prior service cost for the Pension Restoration Plan that will be amortized into income during 2008 are \$19, and \$2, respectively.

SFAS No. 158 also requires that the funded status of a plan be measured as of the date of the year-end for fiscal years ending after December 15, 2008. The current measurement date of September 30 will be changed to December 31 beginning in 2008.

The funding status and the amounts recognized in the Consolidated Statement of Condition for the Association's Pension Restoration Plan follow at December 31, 2007:

	2007
Benefit obligation at the beginning of the period	\$ 17
Interest cost	1
Actuarial gain	(1)
Benefits paid	(16)
Benefit obligation at the end of the period	\$ 1
Change in plan assets	
Company contributions	16
Benefits paid	(16)
Fair value of plan assets at the end of the period	\$ -
Funded status at September 30	\$ (1)
Fourth quarter employer contributions	-
Net amount recognized – December 31	\$ (1)
Amounts recognized in the Consolidated Statement of Condition consist of:	
Liabilities	\$ 1
Net amount recognized	\$ 1

The following represent the amounts included in accumulated other comprehensive income at December 31, 2007:

	Pension Restoration Plan
Net actuarial gain	\$ (78)
Prior service costs	6
Total amount recognized in AOCI	\$ (72)

The projected and accumulated benefit obligation for the Pension Restoration Plan at December 31, 2007 follows.

	2007
Projected benefit obligation	\$ 1
Accumulated benefit obligation	\$ 1

The net periodic pension expense for the defined benefit pension restoration plan included in the Consolidated Statement of Income is comprised of the following at December 31, 2007.

	2007
Components of net periodic benefit income	
Interest cost	\$ 1
Net amortization and deferral	(4)
Net periodic benefit income	\$ (3)

Weighted average assumptions used to determine benefit obligation at December 31:

	2007
Discount rate	6.35%
Rate of compensation increase	5.00%

Weighted average assumptions used to determine net periodic benefit cost for the year ended December 31:

	2007
Discount rate	6.00%
Rate of compensation increase	5.00%

Estimated Future Benefit Payments

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

	Pension Restoration Benefits
2008	\$ 138
2009	\$ 5
2010	\$ 560
2011	\$ 4
2012	\$ 128
2013 – 2017	\$ 49

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 \$143 for 2007, \$115 for 2006 and \$106 for 2005.

NOTE 12 – INTRA-SYSTEM FINANCIAL ASSISTANCE

The Farm Credit Act provided for capital assistance to System institutions experiencing severe financial stress through the issuance, prior to October 1, 1992, by the Financial Assistance Corporation of U.S. Treasury-guaranteed 15-year bonds, of which \$1.261 billion in principal amount was originally issued. The last remaining Financial Assistance Corporation bonds matured and were repaid on June 10, 2005.

Pursuant to the Farm Credit Act, the U.S. Treasury paid \$440 million, on behalf of the System, in interest costs on \$844 million of the Financial Assistance Corporation bonds issued for purposes other than funding Capital Preservation Agreement accruals. The Banks had irrevocably set aside funds, including interest earned, that totaled the \$440 million needed to repay the interest advanced by the U.S. Treasury. On June 10, 2005, the Banks repaid the U.S. Treasury the interest advanced. The Farm Credit Administration Board cancelled the Financial Assistance Corporation's charter as of December 31, 2006.

NOTE 13 – 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 schedule 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.

	2007	2006	2005
New loans	\$ 16,705	\$ 14,566	\$ 14,981
Repayments	\$ 18,773	\$ 11,560	\$ 16,355
Ending balance	\$ 18,915	\$ 20,172	\$ 19,244

In the opinion of management, none of these loans outstanding at December 31, 2007 involved more than a normal risk of collectibility.

The Association also has business relationships with certain other System entities. The Association paid \$353 to AgVantis for technology services and \$90 to AgBank for operational services during 2007.

NOTE 14 – REGULATORY ENFORCEMENT MATTERS

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

NOTE 15 – 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 financial statements. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. Commercial letters of credit are agreements to pay a beneficiary under conditions specified in the letter of credit. Commitments and letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee by the borrower. At December 31, 2007, \$196,080 of commitments to extend credit and \$1,279 of commercial 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 and letters of credit is substantially the same as that involved in extending loans to borrowers and management applies the same credit policies to these commitments. Upon fully funding a commitment, the credit risk amounts are equal to the contract amounts, assuming that borrowers fail completely to meet their obligations and the collateral or other security is of no value. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower.

There are no actions pending against the Association in which claims for monetary damages are asserted.

NOTE 16 – 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, 2007, 2006 and 2005. The fair value of a financial instrument is generally defined as the amount at

which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Quoted market prices are generally not available for certain 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					
	2007		2006		2005	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:						
Loans and notes receivable, net	\$ 401,293	\$ 403,582	\$ 398,056	\$ 395,135	\$ 391,705	\$ 385,956
Cash	\$ 4,784	\$ 4,784	\$ 3,299	\$ 3,299	\$ 1,731	\$ 1,731
Financial liabilities:						
Notes payable to AgBank	\$ 304,264	\$ 306,654	\$ 308,125	\$ 306,131	\$ 305,653	\$ 303,167
Advance conditional payments	\$ 8,353	\$ 8,353	\$ 3,678	\$ 3,678	\$ 4,464	\$ 4,464

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 and notes receivable: 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. Notes 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 17 – QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

Quarterly results of operations for the years ended December 31, 2007, 2006 and 2005, follow.

	2007				
	First	Second	Third	Fourth	Total
Net interest income	\$ 3,129	\$ 3,115	\$ 3,217	\$ 3,227	\$ 12,688
(Loan loss reversal)/Provision for loan loss	(51)	530	133	(91)	521
Noninterest expense, net	498	596	402	1,026	2,522
Net income	\$ 2,682	\$ 1,989	\$ 2,682	\$ 2,292	\$ 9,645

	2006				
	First	Second	Third	Fourth	Total
Net interest income	\$ 2,898	\$ 3,082	\$ 3,090	\$ 2,816	\$ 11,886
(Loan loss reversal)/Provision for loan loss	(141)	(1,642)	67	(970)	(2,686)
Noninterest expense, net	728	566	645	1,017	2,956
Net income	\$ 2,311	\$ 4,158	\$ 2,378	\$ 2,769	\$ 11,616

	2005				
	First	Second	Third	Fourth	Total
Net interest income	\$ 2,967	\$ 2,743	\$ 2,794	\$ 2,882	\$ 11,386
Provision for loan loss/(Loan loss reversal)	1,498	1,914	(127)	896	4,181
Noninterest expense, net	510	753	657	794	2,714
Net income	\$ 959	\$ 76	\$ 2,264	\$ 1,192	\$ 4,491

Report of Independent Auditors

To the Board of Directors and Shareholders of
Farm Credit of Southwest Kansas, ACA:

In our opinion, the accompanying consolidated balance sheets 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 Southwest Kansas, ACA and subsidiaries (the Association) at December 31, 2007, 2006 and 2005, 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 28, 2008

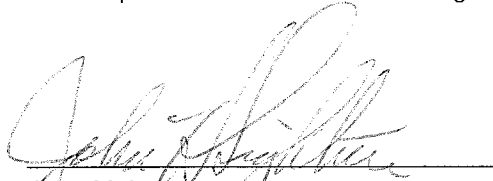
REPORT OF MANAGEMENT

The financial statements of the Farm Credit of Southwest Kansas, 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 Board of Directors has overall responsibility for the Association's system of internal control and financial reporting. The Board 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 Board.

The undersigned certify the Farm Credit of Southwest Kansas, ACA Annual Report has been prepared in accordance with all applicable statutory or regulatory requirements and that the information contained herein is true, accurate, and complete to the best of our knowledge.



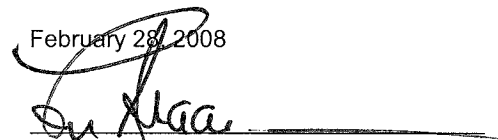
John Lightner
Chairman of the Board

February 28, 2008



John Mark Anderson
President

February 28, 2008



Les Isaac
Sr. Vice President/Finance & Operations

February 28, 2008

AUDIT COMMITTEE REPORT

The Audit Committee (Committee) is comprised of three Directors of Farm Credit of Southwest Kansas, ACA (the Association) Board of Directors. In 2007, ten 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 2007.


The fees paid for professional services rendered for the Association by its independent auditor, PwC, during 2007 were \$22,132 for audit services, and \$5,300 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, 2007 (the "Audited Financial Statements") with management. The Committee also reviews with/receives from 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 Stockholders for the year ended December 31, 2007.



Doug Stucky, Chairman of the Audit Committee

Audit Committee Members

John Lightner
Jerald Doornbos

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
1606 East Kansas Ave. Garden City, Kansas (620) 275-4281	Office Building (Main Office)	Owned
1422 South Main Scott City, Kansas (620) 872-5391	Office Building (Branch Office)	Owned
2451 North Kansas Ave. Liberal, Kansas (620) 624-0171	Office Building (Branch Office)	Owned
2306 First Avenue Dodge City, Kansas (620) 227-8211	Office Building (Branch Office)	Owned

LEGAL PROCEEDINGS AND ENFORCEMENT ACTIONS

Information required to be disclosed in this section is incorporated herein by reference from Notes 14 to the financial statements, "Regulatory Enforcement Matters," and Note 15 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 8 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 7 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 and Intra-System financial assistance rights and obligations, required to be disclosed in this section is incorporated herein by reference from Note 12 to the financial statements, "Intra-System Financial Assistance," and Note 15 included in this annual report to shareholders.

SELECTED FINANCIAL DATA

The selected financial data for the five years ended December 31, 2007, 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

John Lightner, Chairman, Garden City, is a full time farmer with an irrigated corn, soybean, and alfalfa operation. He is President and owner of J&C Lightner, Inc., which is engaged in agricultural production. John has a Bachelor of Science Degree in Business Agronomy from Oklahoma State University. He was first elected to the board in 1995 and his current three year term expires in 2010.

Jerold Doornbos, Vice Chairman, Scott City, is a full time farmer and feedlot operator with a dryland and irrigated crop production operation and is a consulting veterinarian. He is owner of Doornbos Farms and Doornbos Cattle Co. Jerold received his Doctor of Veterinary Medicine degree from Kansas State University. He was first elected to the board in 1983 and his current three year term expires in 2010.

Irvin Caldwell, Garden City, is a farmer / stockman with a small cow herd, alfalfa, corn and milo operation. He is currently a director for the Finney County Water Users board. Irvin received his Bachelors degree in Animal Husbandry from Kansas State University. He was first elected to the board in 1993 and his current three year term expires in 2008.

Jack Hamlin, Moscow, is a full time farmer with an irrigated wheat, corn, soybeans, milo, and potato operation. He is a former director for the Soil Conservation Board. Jack was first elected to the board in 2005 and his current three year term expires in 2008.

Gary Harshberger, Dodge City, is a full time farmer and stockman. His operation consists of dryland and irrigated wheat, corn, milo, and soybeans with a summer grass stocker program. Gary is President of Double H Farms, Inc. and a director of Conestoga Energy, which is involved in the ethanol industry. He has a Bachelor of Science Degree in Computer and Electrical Engineering from Kansas State University. Gary was first elected to the board in 1997 and his current three year term expires in 2009.

Michael Hubbell, Spearville, is a full time farmer with an irrigated corn, soybean, dryland wheat and milo operation. He has a stocker cattle and cow herd operation. Michael is the Vice President of Hubbell and Hubbell, Inc., which is engaged in agricultural production. He has a Bachelor of Science Degree in Animal Science from Kansas State University. Michael was first elected to the board in 2007 and his current three year term expires in 2010.

Larry Kepley, Ulysses, is a farmer / stockman with an operation consisting of wheat seed production and sales, corn and milo production and a beef cow herd. His operation includes both dryland and irrigated production. He is the owner of Kepley Wheat Seed. Larry has numerous affiliations and board relationships including the following: former Direct Foods Member, Kansas Wheat Commission board member, and U.S. Wheat Association board member. He is a former board member of Farm Bureau, Pork Association, Kansas Association of Wheat Growers, Ground Water Management District, Southwest Kansas Irrigation, Cimarron Basin Advisory, Governors Agriculture Advisory Board, and the National Farm Credit Council. Larry received a Bachelors degree from Kansas State University and holds certifications in both Rural Land Appraisal and Farm Management. Larry was first elected to the board in 1976 and his current three year term expires in 2009.

Richard Miller, Leoti, is a full time farmer with a wheat, corn, and milo production operation. He is President of Miller Ag, Inc. and Secretary of R&M Miller Farms, Inc., both of which are engaged in the business of crop production. Richard is a member of the Wichita County Farm Bureau. He has a Bachelor of Science degree in Business Administration from Kansas State University. Richard was first elected to the board in 1994 and his current three year term expires in 2009.

Larry Ochs, Syracuse, is a full time farmer with a dryland wheat and milo operation. He also does custom planting and harvesting. Larry is the owner of Ochs Farms and a partner in Nairn Land, LLC, both of which are engaged in production agriculture. Larry is the elected Mayor of the City of Syracuse, Kansas. He was first elected to the board in 1987 and is current three year term expires in 2008.

Doug Stucky, Appointed Director, Cimarron, is Executive Manager with the Farm Management Association Southwest. He is involved with agricultural accounting and tax preparation. Doug is an Agricultural Economics faculty member with Kansas State University, a member of the Southwest Farm Management Association, and an Executive Economist since 1992. He has a Bachelor of Science degree in Agricultural Education from Kansas State University and a Kansas Series 63 Security License. Doug was first appointed to the board in 2003 and his current three year term expires in 2009.

Carl Hubbell, Spearville, was first elected to the board in 1986 and his term expired in April 2007.

Senior Officers

John Mark Anderson, President, has been an employee of the Farm Credit System since 1979. Mark has served as President of the Association since September 2002 after being promoted to that position by the Board of Directors from his previous position as Executive Vice President of the Association. Mark has a Bachelor of Science degree in Business Administration from Kansas State University.

Daniel Kollhoff, Executive Vice President, has been an employee of the Farm Credit System for 29 years. Dan has served in his current position since September 2002, and as Senior Vice President Credit and Supervision prior to that time. He is primarily responsible for credit supervision and participation loans. Dan has a Bachelor of Science degree in Business from Fort Hays State University.

Bruce Howard, Senior Vice President – Credit and Supervision, has been a Farm Credit System employee since September 1980. Bruce has served in his present position over the past five years. He is primarily responsible for credit approval and lending branch supervision. Bruce has a Bachelor of Arts degree in Business Administration from Wichita State University.

Les Isaac, Senior Vice President – Finance and Operations, has been a Farm Credit System employee since January 1984. Les has served in his present position over the past five years and is responsible for the supervision of corporate accounting, controls, and technology. He has a Bachelor of Science in Agricultural Economics from Kansas State University and a Master of Business Administration degree from Friends University.

Stephen Stephens, Senior Vice President – Appraisal and AICR, has been a Farm Credit System employee since June 1980. He has held his current position over the past five years and is responsible for the supervision and completion of all appraisal activities of the Association's appraisal staff. Steve also manages the Association Internal Credit Review (AICR) program. He holds accreditation in the field of appraisal including; Certified General Real Property Appraiser from the State of Kansas, and Accredited Rural Appraiser from the American Society of Farm Managers and Rural Appraisers. Steve earned a Bachelor of Science in Agricultural Economics Degree from Kansas State University and a Master of Agribusiness degree from Kansas State University.

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 \$0.485 per mile while on official business.

Additional information for each director follows.

Name	Number of Days Served at Board Meetings	Number of Days Served in Other Official Activities	Total Compensation Paid During 2007
John H. Lightner	16.5	19.250	\$ 14,300
Jerold A. Doornbos	15.0	17.625	13,050
Irvin Caldwell	16.5	17.000	13,400
Jack Hamlin	15.0	16.000	12,400
Gary Harshberger	13.5	16.625	12,050
Mike Hubbell	10.5	6.000	6,600
Larry R. Kepley	15.0	19.000	13,600
Richard W. Miller	15.0	15.000	12,000
Larry R. Ochs	16.5	18.000	13,800
Doug Stucky	16.5	21.250	15,100
Carl Hubbell	6.0	4.000	4,000
Total Compensation			\$ 130,300

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 \$58,860 in 2007, \$76,700 in 2006 and \$81,510 in 2005. There was no non-cash compensation paid to directors during 2007.

Information on the President's and senior officer compensation is provided below. The President's compensation is not included in the senior officer compensation in accordance with the change in FCA regulations.

President	Annual					Total
	Year	Salary	Incentive	Deferred	Other*	
John M. Anderson	2007	\$ 175,092	\$ 28,989	\$ 1,622	\$ 1,646	\$ 207,349
John M. Anderson	2006	\$ 168,992	\$ 12,490	\$ 2,564	\$ 1,466	\$ 185,512
John M. Anderson	2005	\$ 151,987	\$ 25,190	\$ 1,549	\$ 1,423	\$ 180,149

Aggregate Number of Officers	Annual					Total
	Year	Salary	Incentive	Deferred	Other*	
5	2007	\$ 581,726	\$ 93,144	\$ 8,125	\$ 3,226	\$ 686,221
5	2006	\$ 547,549	\$ 43,371	\$ 8,129	\$ 3,100	\$ 602,149
5	2005	\$ 527,034	\$ 86,329	\$ 7,862	\$ 3,401	\$ 624,626

*Other represents annual leave payout.

In addition to base salary, senior officers can earn additional compensation under an annual incentive plan which is tied to the overall business performance and the individual's rating. The incentive plan is based on a fiscal year and is designed to motivate employees to exceed financial and credit quality performance targets approved by the Board of Directors. These targets typically include return on assets, credit quality, credit administration, loan volume, nonaccrual loan volume, cost of operations, permanent capital and other key ratios. Incentives are shown in the year awarded. All employees are covered by an incentive plan.

Disclosure of information on the total compensation paid during the last fiscal year to any senior officer, or to any other officer included in the aggregate, is available 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 13 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 7. Financial assistance agreements between the Association and AgBank are discussed in Note 8. 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 28, 2008, 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 year end. A copy of these reports may be obtained free upon request from the Association. The Association is located at 1606 East Kansas Avenue, Garden City, Kansas 67846, or may be contacted by calling (620) 275-4281.