

**FEDERAL LAND BANK ASSOCIATION
OF SOUTH ALABAMA, FLCA**

**2008
Quarterly Report
Second Quarter**



For the Quarter Ended June 30, 2008



Part of the Farm Credit System

REPORT OF MANAGEMENT

The financial statements of the Federal Land Bank Association of South Alabama, FLCA (Association) are prepared by management, who are responsible for the statements' 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. Other financial information included in the quarterly report is consistent with that in the financial statements.

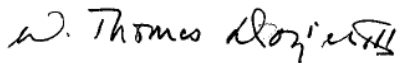
To meet its responsibility for reliable financial information, management depends on the Farm Credit Bank of Texas' (Bank) and the Association's accounting and internal control systems, which have been designed to provide reasonable, but not absolute, assurance that assets are safeguarded and transactions are properly authorized and recorded. The systems have been designed to recognize that the cost of controls must be related to the benefits derived. The annual financial statements are audited by PricewaterhouseCoopers LLP, independent accountants, who conduct a review of internal controls solely for the purpose of establishing a basis for reliance thereon in determining the nature, extent and timing of audit tests applied in the audit of the financial statements in accordance with generally accepted auditing standards. The Association is also examined by the Farm Credit Administration.

The audit committee of the board of directors has oversight responsibility for the Association's system of internal controls and financial reporting. The audit committee consults regularly with management and meets periodically with the independent auditors and the internal auditor to review the scope and results of their work. The independent auditors and internal auditor have direct access to the audit committee.

The undersigned certify that, to the best of our knowledge and belief, the financial statements and other financial information included in this quarterly report reliably present the financial condition of the Federal Land Bank Association of South Alabama, FLCA and the results of its operations for the periods shown.



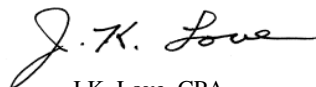
Douglas Thiessen
Chief Executive Officer
August 1, 2008



W. Thomas Dozier, III
Chairman, Board of Directors
August 1, 2008



M. Scott Sellers, CPA
Sr. VP/Chief Financial Officer
August 1, 2008



J.K. Love, CPA
Chairman, Audit Committee
August 1, 2008

FEDERAL LAND BANK ASSOCIATION OF SOUTH ALABAMA, FLCA MANAGEMENT'S DISCUSSION AND ANALYSIS

The following commentary reviews the financial performance of the Federal Land Bank Association of South Alabama, FLCA (Federal Land Credit Association), referred to as the Association, for the quarter and six months ended June 30, 2008. These comments should be read in conjunction with the accompanying financial statements and the December 31, 2007 Annual Report of the Association.

The financial statements were prepared under the oversight of the Association's audit committee.

Results of Operations:

The Association had net income of \$2,863,434 and \$5,813,789 for the three and six months ended June 30, 2008, as compared to net income of \$679,731 and \$3,664,163 for the same periods in 2007 reflecting an increase of 321.3 and 58.7 percent, respectively. Net interest income was \$3,970,739 and \$7,964,743, respectively, for the three and six months ended June 30, 2008, compared to \$3,846,488 and \$7,835,661 for the same periods in 2007. Interest income decreased by \$929,428 or 4.8 percent, from the first six months of 2007, primarily due to declines in yields on earning assets, offset partially by an increase in average loan volume. Interest expense for the first six months of 2008 decreased by \$1,058,510, or 9.1 percent, from the same periods of 2007 due to a decrease in interest rates, offset partially by an increase in average debt volume. The provision for loan losses for the first six months of 2008 decreased by \$2,043,415, or 101.1 percent, over the same period of 2007, due to specific reserves recorded for two large credits in the second quarter of 2007. One of the credits and related specific reserves remains on the Association's books as of June 30, 2008, and is discussed further in the "Risk Exposure" and "Legal Proceedings" sections of Management's Discussion and Analysis, below. Average loan volume for the second quarter of 2008 was \$559,256,117, compared to \$514,369,185 in the second quarter of 2007.

Noninterest income for the three and six months ended June 30, 2008 increased by \$388,175 and \$772,193, or 97.3 percent and 87.0 percent, respectively, over the same periods of 2007. These increases are due primarily to higher patronage income from Farm Credit Bank of Texas (the Bank) in the first six months of 2008 as compared to the first six months of 2007. The increase in patronage is due almost entirely to the fact that in 2008, the Association began accruing Direct Note patronage from the Bank on a monthly basis. Accordingly, six months of estimated Direct Note patronage, to be received at year end, have been accrued into income as of June 30, 2008. As this is the first year of accruing this income during the year, no such income was reflected for the

comparable periods in 2007. Also contributing to the increase in noninterest income is an increase in loan fees caused by proportionately higher activity in loan closings and loan servicing fees, and an increase in the Association's pro-rata share of earnings in the Farm Credit System Association Captive Insurance Company (the Captive).

Noninterest expenses for the three and six months ended June 30, 2008 increased by \$380,502 and \$744,589, or 25.5 percent and 25.5 percent, respectively, as compared to the same periods in 2007. These respective increases are due primarily to an increase in salaries and employee benefits expense and purchased services expense. The increases in expense were partially offset by an increase in CMS expense reimbursements. The increase in salaries and employee benefits is primarily due to an increase in contributions to the defined benefit retirement plan. For more information on the defined benefit plan refer to the 2007 Annual Report. Purchased services increased primarily due to legal and consulting fees incurred in connection with protecting the Association's interests in credit-related matters with a borrower with a large credit from the Association, as noted below in the "Risk Exposure" section of the Management's Discussion and Analysis and Note 6, "Commitments and Contingencies," to the financial statements included in this quarterly report. This increase in legal and consulting fees also directly resulted in the increase in CMS expense reimbursements, since the underlying loan was originated through the CMS group, and therefore a portion of the expense was subject to reimbursement. For further discussion, see Note 4, "Capital Markets," to the financial statements included in this quarterly report.

The Association recorded no recoveries and no charge-offs for the quarter ending June 30, 2008, and no recoveries and \$1,025,200 in charge-offs for the same period in 2007. The Association's allowance for loan losses was 0.1 percent and 0.3 percent of total loans outstanding as of June 30, 2008, and 2007, respectively.

The Association's return on average assets for the six months ended June 30, 2008, was 2.02 and 1.40 percent for the same period in 2007. The Association's return on average equity for the six months ended June 30, 2008, was 12.12 and 8.12 percent for the same period in 2007.

Loan Portfolio:

The Association makes and services loans, secured by a first lien on real estate, to farmers, ranchers, rural homeowners and certain farm-related businesses. The majority of the loans serviced by the Association contain provisions for variable interest rates and are long-term. Loans serviced by the Association offer several installment payment cycles, the timing of which usually coincides with the seasonal cash-flow capabilities of the borrower.

Total loans outstanding at June 30, 2008, stated at recorded investment (principal less funds held), were \$565,880,691 compared to \$542,069,361 at December 31, 2007, reflecting an increase of 4.4 percent. The major commodities within the Association's loan portfolio are timber, cattle, poultry, and field crops.

The following table reflects the credit quality of the Association's loan volume as of:

	June 30, 2008	December 31, 2007
Acceptable	98.3 %	99.0 %
Special Mention	0.7 %	0.4 %
Substandard	1.0 %	0.6 %
Total	100.0 %	100.0 %

Risk Exposure:

High-risk assets include nonaccrual loans, loans that are past due 90 days or more and still accruing interest, formally restructured loans and other property owned. The following table illustrates the Association's components and trends of high-risk assets.

	June 30, 2008		December 31, 2007	
	Amount	%	Amount	%
Nonaccrual	\$ 2,876,417	94.5%	\$ 2,942,308	97.0%
90 days past due and still accruing interest	94,381	3.1%	-	0.0%
Formally restructured	-	0.0%	-	0.0%
Other property owned, net	71,600	2.4%	92,075	3.0%
Total	\$ 3,042,398	100.0%	\$ 3,034,383	100.0%

At June 30, 2008 loans that were considered impaired were \$2,970,798, compared to \$2,942,308 at December 31, 2007. This represents 0.5 percent and 0.5 percent of loan volume, respectively. Impaired loans consist of all high-risk assets except other property owned, net.

The Association originated a loan to one borrower through the Capital Markets of the South (CMS) and participated the loan to 13 other Farm Credit associations, with the Association serving as the lead lender. The original funded balance of the loan was \$68,500,000, and the Association retained 5.56% of the loan. During the second quarter of 2007, the loan was deemed to be nonaccrual due to its significant undercollateralized position and a credit default. The Association is currently pursuing collection efforts, and in the third quarter of 2007 liquidated part of the loan's collateral, which was applied to the outstanding balance for all participants. In addition, in the second half of 2007 the Association, along with the four other CMS member associations,

repurchased, on a pro-rata basis, the portions of the loan held by all other non-CMS participants. During 2007, charge-offs of \$30,245,000 were recognized, and specific reserves of \$1,460,000 remain on the books related to this loan. The Association’s portion of charge-offs and specific reserves were \$4,814,212 and \$279,022, respectively. No further charge-offs or allowance reserves have been required to be recognized in 2008, and as of June 30, 2008, the Association’s portion of the loan’s remaining book balance is \$2,046,965. For more information on impaired loans and the allowance for loan losses, see Note 2 to the financial statements, “Allowance for Loan Losses,” included in this quarterly report. As part of loan repurchase transactions noted above, the Association received a general release from the non-CMS participants for claims related to the loan, and agreed to indemnify the non-CMS participants from any liability arising from legal proceedings related to the loan.

Liquidity and Funding Sources:

The Association secures the majority of its lendable funds from the Bank, which obtains its funds through the issuance of Systemwide obligations and with lendable equity. The following schedule summarizes the Association’s borrowings.

	June 30, 2008	December 31, 2007
Note payable to the Bank	\$ 482,754,945	\$ 463,189,388
Accrued interest on note payable	1,671,897	2,065,294
Total	<u>\$ 484,426,842</u>	<u>\$ 465,254,682</u>

Capital Resources:

The Association’s capital position increased by \$2,654,498 at June 30, 2008, compared to December 31, 2007. The Association’s debt as a ratio to members’ equity was 5.00:1 as of June 30, 2008, compared to 4.92:1 as of December 31, 2007.

In March 2008, the board declared a \$3,200,000 cash patronage to be paid to stockholders from the Association’s 2007 earnings. The patronage distribution was completed in April 2008. See Note 3, “Capital,” to the financial statements included in this quarterly report for further discussion.

Under regulations governing minimum permanent capital adequacy and other capitalization issues, the Association is required to maintain a minimum adjusted permanent capital of seven percent of risk-adjusted assets as defined by the FCA. The Association’s permanent capital ratio at June 30, 2008, was 15.6 percent, which is in compliance with the FCA’s minimum permanent capital standard. The Association’s core surplus ratio and total surplus ratio at June 30, 2008, were 15.0 and 15.0 percent, respectively, which is in compliance with the FCA’s minimum surplus standard.

Legal Proceedings:

In relation to the loan described in the “Risk Exposure” section of Management’s Discussion and Analysis, above, the Association is involved in two lawsuits as of the date of this report. The overall character of the lawsuits is of collection of the principal and interest from the borrower and control of the loan’s collateral. These legal proceedings are described in more detail in Note 6, “Commitments and Contingencies,” to the financial statements included in this quarterly report.

These legal proceedings have the potential to be very lengthy and the outcome is unknown at this time. However, the Association has been and will remain vigorous in pursuit of collection of the loan balances outstanding and other potential sources of recovery, and in defense of the counter-claims asserted by the borrower and others against the Association. The Association’s legal counsel believes that the Association’s claims are supported by facts and applicable law, and have a reasonable chance of success, and at the same time believes that the claims of the borrower and other defendants are without merit and the Association will likely be successful in its defense against such claims.

Relationship with the Farm Credit Bank of Texas:

The Association’s financial condition may be impacted by factors that affect the Bank. The financial condition and results of operations of the Bank may materially affect the stockholder’s investment in the Association. The Management’s Discussion and Analysis and Notes to Financial Statements contained in the December 31, 2007 Annual Report of FLBA of South Alabama, FLCA more fully describe the Association’s relationship with the Bank.

The Tenth Farm Credit District’s (District) annual and quarterly stockholder reports are available free of charge, upon request. These reports can be obtained by writing to Farm Credit Bank of Texas, The Ag Agency, P.O. Box 202590, Austin, Texas 78720, or by calling (512) 483-9260. Copies of the District’s quarterly and annual stockholder reports also can be requested by e-mail at fcf@farmcreditbank.com. The District makes its annual and quarterly stockholder reports available on its web site at www.farmcreditbank.com.

The Association’s annual and quarterly stockholder reports are also available free of charge, upon request. These reports can be obtained by writing to the Federal Land Bank Association of South Alabama, FLCA, P.O. Box 241687, Montgomery, Alabama, 36124-1687 or by calling (334) 270-8687. Copies of the reports can also be requested by e-mailing awolf@farmcreditbank.com. The Association’s quarterly stockholder reports are available on its website at www.alabamalandloan.com approximately 40 days after each quarter end, and the annual stockholder report is available on its website 75 days after fiscal year end. Copies of the annual stockholder report can also be requested 90 days after fiscal year end.

FEDERAL LAND BANK ASSOCIATION OF SOUTH ALABAMA, FLCA

BALANCE SHEET

	June 30, 2008 (unaudited)	December 31, 2007
<u>ASSETS</u>		
Cash	\$ 677,173	\$ 1,250,729
Loans	565,880,691	542,069,361
Less: allowance for loan losses	494,679	552,564
Net loans	<u>565,386,012</u>	<u>541,516,797</u>
Accrued interest receivable	8,660,935	9,361,142
Investment in and receivable from the Bank:		
Capital stock	8,736,625	8,736,625
Accrued patronage receivable	695,000	351,309
Other property owned, net	71,600	92,075
Premises and equipment	1,641,567	1,630,274
Other assets	593,494	258,982
Total assets	<u>\$ 586,462,406</u>	<u>\$ 563,197,933</u>
 <u>LIABILITIES</u>		
Note payable to the Bank	\$ 482,754,945	\$ 463,189,388
Accrued interest payable	1,671,897	2,065,294
Drafts outstanding	2,269,076	324,967
Other liabilities	1,964,655	2,470,949
Total liabilities	<u>488,660,573</u>	<u>468,050,598</u>
 <u>MEMBERS' EQUITY</u>		
Capital stock and participation certificates	3,404,660	3,326,230
Unallocated retained earnings	94,134,149	91,538,558
Accumulated other comprehensive income	263,024	282,547
Total members' equity	<u>97,801,833</u>	<u>95,147,335</u>
Total liabilities and members' equity	<u>\$ 586,462,406</u>	<u>\$ 563,197,933</u>

The accompanying notes are an integral part of these financial statements

FEDERAL LAND BANK ASSOCIATION OF SOUTH ALABAMA, FLCA

STATEMENT OF INCOME
(unaudited)

	Quarter Ended		Six Months Ended	
	June 30,		June 30,	
	2008	2007	2008	2007
<u>INTEREST INCOME</u>				
Loans	\$ 9,051,747	\$ 9,779,691	\$ 18,601,048	\$ 19,530,476
<u>INTEREST EXPENSE</u>				
Note payable to the Bank	5,081,008	5,933,203	10,636,305	11,694,815
Net interest income	3,970,739	3,846,488	7,964,743	7,835,661
<u>PROVISION FOR LOSSES</u>				
Provision for loan losses (provision reversal)	18,847	2,070,626	(22,881)	2,020,534
Provision for acquired property losses	-	-	20,475	-
Net interest income after provision for losses	3,951,892	1,775,862	7,967,149	5,815,127
<u>NONINTEREST INCOME</u>				
Patronage income from the Bank	440,421	109,547	891,060	218,755
Loan fees	343,080	294,464	710,475	627,022
Financially related services income	1,031	1,147	2,534	2,741
Gain (loss) on sale of premises and equipment, net	784	(5,994)	2,272	(5,994)
Other noninterest income	2,023	-	53,254	44,878
Total noninterest income	787,339	399,164	1,659,595	887,402
<u>NONINTEREST EXPENSES</u>				
Salaries and employee benefits	1,086,652	895,327	2,157,667	1,842,346
Directors' expense	65,648	63,615	126,817	124,188
Purchased services	574,698	195,111	1,365,593	392,082
Travel	98,620	62,636	164,833	129,949
Occupancy and equipment	62,988	61,222	123,240	115,106
Communications	24,503	19,152	47,380	39,316
Advertising	46,782	24,357	75,356	39,668
Public and member relations	35,564	18,512	66,766	55,443
Supervisory and exam expense	54,384	46,654	108,770	93,309
FC/SIC insurance expense	225,894	208,894	463,087	417,574
Other noninterest expense	26,186	37,099	47,504	55,577
CMS expense reimbursements	(426,122)	(137,284)	(934,058)	(266,192)
Total noninterest expenses	1,875,797	1,495,295	3,812,955	3,038,366
Net income	\$ 2,863,434	\$ 679,731	\$ 5,813,789	\$ 3,664,163

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

FEDERAL LAND BANK ASSOCIATION OF SOUTH ALABAMA, FLCA

STATEMENT OF CHANGES IN MEMBERS' EQUITY

(unaudited)

	Capital Stock/ Participation Certificates	Unallocated Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
Balance at December 31, 2006	\$ 3,150,865	\$ 87,388,071	\$ -	\$ 90,538,936
Net income	-	3,664,163	-	3,664,163
Capital stock/participation certificates issued	354,260	-	-	354,260
Capital stock/participation certificates retired	(281,820)	-	-	(281,820)
Stock equalization	-	-	-	-
Patronage refunds:				
Cash	-	(3,000,000)	-	(3,000,000)
Change in patronage declared and paid	-	15,143	-	15,143
Balance at June 30, 2007	<u>\$ 3,223,305</u>	<u>\$ 88,067,377</u>	<u>\$ -</u>	<u>\$ 91,290,682</u>
Balance at December 31, 2007	\$ 3,326,230	\$ 91,538,558	\$ 282,547	\$ 95,147,335
Comprehensive income				
Net income	-	5,813,789	-	5,813,789
Other comprehensive income				
Amortization of costs included in net periodic pension costs	-	-	(19,523)	(19,523)
Comprehensive income	-	5,813,789	(19,523)	5,794,266
Effects of accounting change regarding measurement date of postretirement benefits plans pursuant to FASB Statement No. 158 (See Note 5)	-	(18,492)	-	(18,492)
Capital stock/participation certificates issued	344,800	-	-	344,800
Capital stock/participation certificates retired	(266,370)	-	-	(266,370)
Patronage refunds:				
Cash	-	(3,200,000)	-	(3,200,000)
Change in patronage declared and paid	-	294	-	294
Balance at June 30, 2008	<u>\$ 3,404,660</u>	<u>\$ 94,134,149</u>	<u>\$ 263,024</u>	<u>\$ 97,801,833</u>

The accompanying notes are an integral part of these financial statements

FEDERAL LAND BANK ASSOCIATION OF SOUTH ALABAMA, FLCA
NOTES TO THE FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES:

The Federal Land Bank Association of South Alabama, FLCA (Federal Land Credit Association), referred to as the Association, is a member-owned cooperative that provides credit and credit-related services to or for the benefit of eligible borrowers/stockholders for qualified agricultural purposes. The Association serves the counties of Autauga, Baldwin, Barbour, Bibb, Bullock, Butler, Chambers, Chilton, Choctaw, Clarke, Coffee, Conecuh, Coosa, Covington, Crenshaw, Dale, Dallas, Elmore, Escambia, Geneva, Greene, Hale, Henry, Houston, Lee, Lowndes, Macon, Marengo, Mobile, Monroe, Montgomery, Perry, Pickens, Pike, Russell, Sumter, Tallapoosa, Tuscaloosa, Washington and Wilcox in the state of Alabama. The Association is a lending institution of the Farm Credit System (the System), which was established by Acts of Congress to meet the needs of American agriculture.

A description of the Association's significant accounting policies and the financial condition and results of operations as of December 31, 2007 are contained in the 2007 Annual Report to the stockholders. These unaudited second quarter 2008 financial statements should be read in conjunction with the 2007 Annual Report to the stockholders.

The accompanying financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations and conform with generally accepted accounting principles, except for the inclusion of a statement of cash flows. Generally accepted accounting principles require a business enterprise that provides a set of financial statements reporting both financial position and results of operations to also provide a statement of cash flows for each period for which results of operations are provided. In regulations issued by FCA, associations have the option to exclude statements of cash flows in interim financial statements. Therefore, the Association has elected not to include a statement of cash flows in these financial statements.

The preparation of these financial statements requires the use of management's estimates. The results for the quarter ended June 30, 2008 are not necessarily indicative of the results to be expected for the year ended December 31, 2008. Certain amounts in the prior period's financial statements have been reclassified to conform to current financial statement presentation.

NOTE 2 — ALLOWANCE FOR LOAN LOSSES:

The allowance for loan losses is maintained at a level considered adequate by management to provide for estimated 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. An analysis of the allowance for loan losses follows:

	June 30, 2008	June 30, 2007
Balance at beginning of quarter	\$ 475,832	\$ 405,495
Provision for loan losses	18,847	2,070,626
Charge-offs	-	(1,025,200)
Recoveries	-	-
Balance at end of quarter	<u>\$ 494,679</u>	<u>\$ 1,450,921</u>

The following table presents information concerning impaired loans:

	June 30, 2008	June 30, 2007
Impaired loans with related allowance	\$ 2,129,416	\$ 5,891,701
Impaired loans with no related allowance	841,382	261,955
Total impaired loans	<u>\$ 2,970,798</u>	<u>\$ 6,153,656</u>
Allowance on impaired loans	\$ 291,555	\$ 1,287,760
Average impaired loans	\$ 2,937,698	\$ 3,853,383
Interest income on impaired loans for the quarter	\$ 19,638	\$ 15,645

NOTE 3 — CAPITAL:

The Association's board of directors has established a Capital Adequacy Plan (Plan) that includes the capital targets that are necessary to achieve the institution's capital adequacy goals as well as the minimum permanent capital standards. The Plan monitors projected dividends, equity retirements and other actions that may decrease the Association's permanent capital. In addition to factors that must be considered in meeting the minimum standards, the board of directors also monitors the following factors: capability of management; quality of operating policies, procedures, and internal controls; quality and quantity of earnings; asset quality and the adequacy of the allowance for losses to absorb losses within the loan portfolio; sufficiency of liquid funds; needs of an institution's customer base; and any other risk-oriented activities, such as funding and interest rate risk, potential obligations under joint and several liability, contingent and off-balance-sheet liabilities or other conditions warranting

additional capital. At least quarterly, management reviews the Association's goals and objectives with the board.

In March 2008, the board declared a \$3,200,000 cash patronage to be paid to stockholders from the Association's 2007 earnings. The patronage distribution was completed in April 2008.

NOTE 4 — CAPITAL MARKETS:

Until the second quarter of 2007, the Association participated in the Capital Markets of the South (CMS), a joint venture created in 2003 for the purpose of expanding the participants' lending opportunities. The CMS group was comprised of the Association, the Federal Land Bank Association of North Alabama, FLCA, the Land Bank of North Mississippi, FLCA, Land Bank South, FLCA, and the Louisiana Federal Land Bank Association, FLCA. During the second quarter of 2007, the CMS members decided to discontinue the joint venture. The Association will continue to service the existing CMS loan portfolio, with revenue and expenses continuing to be shared accordingly as noted below, until such time as all of the loans are fully matured or paid off.

Pursuant to the terms of the alliance, each of the five CMS participating associations generally share equally in the costs of operating the venture. All CMS noninterest expenses are recorded gross on the Association's books and then reimbursed 80% by the other four associations. The total amount of reimbursements is included on the statement of income in the line item entitled "CMS expense reimbursements." The Association's pro-rata share of income from CMS operations are recorded in the statement of income in their respective line items.

NOTE 5 — EMPLOYEE BENEFIT PLANS:

The following table summarizes the components of net periodic benefit costs for the six months ended June 30,:

	Other Benefits	
	2008	2007
Service cost	\$ 21,536	\$ 22,484
Interest cost	34,972	31,394
Expected return on plan assets	-	-
Amortization of prior service credits	(19,828)	(21,750)
Amortizations of net loss	305	394
Net periodic benefit cost	<u>\$ 36,985</u>	<u>\$ 32,522</u>

In September 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 158 "Employers' Accounting for Defined

Benefit Pension and Other Postretirement Plans” (SFAS 158), which required the recognition of the overfunded or underfunded status of pension and other postretirement benefit plans on the balance sheet. The balance sheet recognition provisions of SFAS 158 were adopted at December 31, 2007. SFAS 158 also requires that employers measure the benefit obligation and plan assets as of the fiscal year end for fiscal years ending after December 15, 2008. In fiscal 2007 and earlier, we used a September 30 measurement date for other postretirement benefit plans. The Standard provides two approaches for an employer to transition to a fiscal year end measurement date. We have applied the second approach, which allows for the use of the measurements determined for the prior year end.

Under this alternative, postretirement benefit expense measured for the three-month period October 1, 2007 to December 31, 2007 (determined using the September 2007 measurement date) was recorded as an adjustment to beginning 2008 retained earnings. As result, the Association decreased retained earnings by \$18,492, and increased the postretirement benefit liability by \$18,492.

The Association previously disclosed in its Annual Report to the stockholders for the year ended December 31, 2007, that it expected to contribute \$22,548 to its postretirement health and welfare benefits plan in 2008. As of June 30, 2008, \$10,491 of contributions have been made. The Association’s liability for the plan’s unfunded accumulated benefit obligation at June 30, 2008 was \$1,148,080 and is included in “Other liabilities” in the balance sheet.

NOTE 6 — COMMITMENTS AND CONTINGENCIES:

As of June 30, 2008, the Association was party to two lawsuits related to a large loan. The loan was originated by the Association to one borrower through CMS and was participated to 13 other Farm Credit associations, with the Association serving as the lead lender. The original funded balance of the loan was \$68.5 million, and the Association retained 5.56% of the loan. During 2007 the loan, which is significantly undercollateralized, was declared to be in default and transferred to nonaccrual status, and collection actions were commenced by the Association. Also during 2007, the Association along with the other CMS member associations, repurchased on a pro-rata basis the portions of the loan held by all other non-CMS participants. As part of the repurchase transactions, the Association received a general release from the non-CMS participants for claims related to the loan, and agreed to indemnify the non-CMS participants from any liability arising from legal proceedings related to the loan.

An initial lawsuit brought in Texas State Court, the domicile state of the Borrower, was commenced for the purpose of obtaining access to collateral for the loan. Such suit was successful and has now been dismissed.

The overall character of the two remaining lawsuits is of collection of the principal and interest from the borrower, control of the loan's remaining collateral and an effort to recover property purchased with the Association's loan proceeds. One of the lawsuits was filed in the borrower's domicile state of Texas in US Federal District Court and involved civil complaints by the Association against the borrower and other related individuals as well as third parties for damages incurred as a consequence of alleged wrongful acts by respective parties and an effort to recover assets acquired with proceeds of the loan from such parties. The borrower and all related defendants in this action have agreed to an injunction precluding the transfer of any assets acquired with proceeds of the loan. The remaining lawsuit was filed in the state of Kentucky, where the primary real estate collateral is located, for the purpose of gaining access to and foreclosing the lien of its mortgages on the real estate and commencing an action for collection of the debt. The Kentucky state court has appointed a receiver to protect the Association's collateral and preserve the status quo pending resolution of the suit. The borrower and other related individuals have responded by filing a counter-claim seeking damages against the Association, alleging various claims, including breach of contract. These legal proceedings have the potential to be very lengthy and the outcome is unknown at this time. However, the Kentucky Court has recently ordered the Receiver to sell all mining equipment that was seized by direction of the court. The proceeds of such sales, some \$750,000 to date, have been impounded subject to resolution of the claims by the Association that it is entitled to the proceeds.

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