



## AUDITOR'S REPORT

### To the Board of Directors of the Agriculture Financial Services Corporation

I have audited the balance sheet of the Agriculture Financial Services Corporation as at March 31, 2006 and the statements of revenue, expense and surplus, and cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Corporation as at March 31, 2006 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

[Original signed by]  
Fred Dunn  
FCA  
Auditor General

Edmonton, Alberta  
May 12, 2006

[The official version of this Report of the Auditor General, and the information the Report covers, is in printed form.]

**Agency – continued****Agriculture Financial Services Corporation – Financial Statements 2005-2006****Balance Sheet as at March 31, 2006***(in thousands)*

	2006	2005
<b>Assets</b>		
Cash	\$ 163,415	\$ 75,456
Accounts receivable <i>(Note 4)</i>	137,103	120,904
Due from Province of Alberta	8,028	50,669
Due from Government of Canada	330,914	293,189
Loans receivable <i>(Note 5)</i>	973,084	977,460
Investments <i>(Note 6)</i>	238,459	171,229
Property and equipment <i>(Note 7)</i>	32,012	26,747
	<b>\$1,883,015</b>	<b>\$1,715,654</b>

**Liabilities and Surplus**

Accounts payable and accrued liabilities	\$ 25,371	\$ 31,481
Estimated indemnities payable <i>(Note 8)</i>	456,883	449,849
Due to Crop Reinsurance Fund of Canada for Alberta	16,630	13,737
Allowance for losses on loan guarantees <i>(Note 14)</i>	824	1,186
Notes payable <i>(Note 9)</i>	897,059	910,653
Deferred revenue <i>(Note 10)</i>	23,867	21,935
	<b>1,420,634</b>	<b>1,428,841</b>
Surplus	462,381	286,813
	<b>\$1,883,015</b>	<b>\$1,715,654</b>

Contingencies and commitments *(Note 14)*

*The accompanying notes and schedules  
are part of these financial statements.*

**Agency – continued****Agriculture Financial Services Corporation – Financial Statements 2005-2006****Statement of Revenue, Expense and Surplus for the Year Ended March 31, 2006***(in thousands)*

	2006 Budget (Note 3(a))	2006 Actual (Schedule 1)	2005 Actual
<b>Revenue</b>			
Premiums from insured persons	\$157,121	\$141,524	\$135,941
Interest	79,185	68,636	71,242
Contribution from Province of Alberta	276,950	468,033	319,922
Contribution from Government of Canada	308,653	290,918	431,378
Investment income	6,809	14,228	10,022
Fees and other income	4,778	4,775	5,374
Reinsurance recoveries	–	10	2,163
	<b>833,496</b>	<b>988,124</b>	976,042
<b>Expense</b>			
Indemnities	657,803	638,984	720,436
Reinsurance	43,518	58,559	44,889
Administration <i>(Schedule 2)</i>	61,551	58,101	60,019
Interest	53,279	45,027	45,647
Adjusting	7,484	7,646	8,072
Farm loan incentives	5,791	4,883	5,077
(Recovery) provision for doubtful accounts and for losses <i>(Note 13)</i>	2,426	(2,877)	1,595
Selling commissions	2,470	2,233	2,027
	<b>834,322</b>	<b>812,556</b>	887,762
Surplus (deficit) for the year	<b>\$ (826)</b>	<b>175,568</b>	88,280
Surplus at beginning of year		286,813	198,533
<b>Surplus at end of year</b>		<b>\$462,381</b>	<b>\$286,813</b>

*The accompanying notes and schedules  
are part of these financial statements.*

**Agency – continued****Agriculture Financial Services Corporation – Financial Statements 2005-2006****Statement of Cash Flows for the Year Ended March 31, 2006***(in thousands)*

	2006	2005
<b>Operating Activities</b>		
Surplus for the year	\$175,568	\$ 88,280
Changes not affecting cash	(1,755)	1,700
Changes in assets and liabilities relating to operations	(8,427)	3,208
<b>Net cash provided by operating activities <sup>(1)</sup></b>	<b>165,386</b>	<b>93,188</b>
<b>Investing Activities</b>		
Proceeds from repayments of loans receivable and sale of properties	190,132	181,109
Loan disbursements	(184,190)	(171,973)
Purchase of investments	(680,013)	(523,780)
Proceeds on disposal of investments	614,452	454,501
Purchase of property and equipment	(11,171)	(9,494)
Proceeds on disposal of property and equipment	517	381
<b>Net cash utilized by investing activities</b>	<b>(70,273)</b>	<b>(69,256)</b>
<b>Financing Activities</b>		
Borrowing from the Province of Alberta	568,581	1,828,362
Repayment of borrowing from the Province of Alberta	(584,385)	(1,840,186)
Government of Canada funding for property and equipment	3,432	619
Province of Alberta funding for property and equipment	5,218	954
<b>Net cash utilized by financing activities</b>	<b>(7,154)</b>	<b>(10,251)</b>
Net increase in cash from operating, investing and financing activities	<b>87,959</b>	13,681
Cash at beginning of year	75,456	61,775
<b>Cash at end of year</b>	<b>\$163,415</b>	<b>\$ 75,456</b>

<sup>(1)</sup> Net cash provided by operating activities includes \$43,184 (2005 \$47,533) of interest paid.

*The accompanying notes and schedules are part of these financial statements.*

## **Agency – continued**

### **Agriculture Financial Services Corporation – Financial Statements 2005-2006**

#### **Notes to the Financial Statements March 31, 2006**

*(in thousands)*

##### **Note 1 Authority and Purpose**

The Agriculture Financial Services Corporation (the "Corporation") operates under the authority of the *Agriculture Financial Services Act*, Chapter A-12 RSA 2000.

The Corporation provides lending and insurance services and compensation programs. Its core programs and services include loans to beginning farmers, commercial lending, crop insurance, hail insurance and agricultural income stabilization payments. It also delivers other programs and services including loans to developing farmers, disaster loans, loan guarantees, and business counseling.

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##### **Note 2 Significant Accounting Policies and Reporting Practices**

These financial statements are prepared in accordance with Canadian generally accepted accounting principles.

###### **(a) Cash**

Cash consists of a deposit in the Consolidated Cash Investment Trust Fund which is managed by the Province of Alberta to provide competitive interest income while maintaining maximum security and liquidity of depositors' capital.

###### **(b) Investments**

Investments are carried at cost or amortized cost unless there is an other than temporary decline in the value of the investments, then the investments are written down to recognize the loss. Premiums and discounts on investments are amortized to investment income using the straight-line method over the period to maturity of the related investment. Gains and losses realized on disposal of investments are included in investment income.

###### **(c) Property and Equipment**

Property and equipment are carried at cost less accumulated amortization. Amortization is recorded on a straight-line basis over the estimated useful lives of the assets as follows:

Building	25 - 40 years
Land improvements	25 years
Software development costs	2 - 10 years
Equipment and furniture	10 years
Vehicles	5 years
Computer equipment	5 years

###### **(d) Notes Payable**

Notes payable are carried at amortized cost. Premiums and discounts on notes payable are amortized to interest expense using the effective yield method over the period to maturity.

###### **(e) Fair Value of Financial Instruments**

Because of the relatively short period to maturity, short-term financial instruments are valued at cost and adjusted for any applicable allowance for doubtful accounts. This is considered to be equivalent to fair value and applies to Cash, Accounts receivable, Due from Province of Alberta, Due from Government of Canada, Accounts payable and accrued liabilities, Estimated indemnities payable and Due to Crop Reinsurance Fund of Canada for Alberta. Fair values of Loans receivable, Investments and Notes payable are disclosed in their respective notes.

## **Agency – continued**

### **Agriculture Financial Services Corporation – Financial Statements 2005-2006**

#### **Note 2** Significant Accounting Policies and Reporting Practices (continued)

##### **(f) Reinsurance**

In accordance with the Federal/Provincial Agricultural Policy Framework Implementation Agreement, two crop reinsurance funds were established. On behalf of the Province, the Corporation administers the provincial fund called the Crop Reinsurance Fund of Alberta. Canada holds the federal fund called the Crop Reinsurance Fund of Canada for Alberta. The Crop Reinsurance Fund of Alberta is included as part of the crop insurance surplus of the Corporation. Contributions to and withdrawals from the Funds are made in accordance with terms and conditions of the agreement (see Note 17).

Estimates of amounts recoverable from non-government reinsurers on premiums, indemnities and adjusting expenses are recorded in Accounts receivable. Reinsurance recoveries are not netted against indemnities, they are separately disclosed under revenue. Reinsurance expenses are not netted against premiums from insured persons or contributions from the Province and Government of Canada; they are separately disclosed under expenses.

##### **(g) Loan Discounting**

Loans made under the Alberta Disaster Assistance Loan Program, Alberta Farm Income Disaster Program, and amounts previously deferred under the Indexed Deferral Plan are discounted when they involve significant concessionary elements. The amounts discounted are being amortized to revenue over the lives of the concessionary terms.

##### **(h) Revenue Recognition**

Interest revenue on loans receivable is recognized on an accrual basis unless the ultimate collectibility of the loan is in doubt. When a loan is classified as impaired, interest revenue is no longer recognized. An impaired loan is a loan in which there is risk of loss to the Corporation for full and timely collection of the debt. Impairment may be due to a security deficiency, inadequate cash flow, economic factors in a specific segment of the industry or a catastrophic event.

Premiums from insured persons, including federal and provincial government contributions, are recognized as income when invoiced to producers.

Federal and provincial contributions for property and equipment acquisitions are recorded as deferred revenue until that revenue is recognized on the same basis as those property and equipment costs are amortized.

Loan fees are recognized when received or at the time of loan disbursement. Other fees are recorded when the Corporation completes the applicable service.

##### **(i) Pensions**

The Corporation participates in multi-employer pension plans with related government entities. Pension costs included in these statements comprise the cost of employer contributions for current service of employees during the year.

##### **(j) Provision for Losses on Loans and Guarantees**

Provisions are established for specifically identified potential losses on loans and guarantees as well as for anticipated but not specifically identified losses. When a loan is identified as impaired, a specific provision is established. Specific provisions are established by reducing the recorded investment in the loan by the discounted fair value of the security and the estimated costs to collect. Specific provisions are determined in this manner because the amounts and timing of future cash flows cannot be estimated with reasonable reliability. The provision for doubtful accounts is adjusted for the change in the present value of the security held.

The majority of the Corporation's loan portfolio is with beginning and developing business operations and hence, is subject to high risk. The Corporation recognizes this by providing significant general allowances for doubtful accounts. In establishing the general component of the allowance, management estimates loss percentages based on risks and applies them to loans receivable balances. Risk is based on land value trends, the impact of federal and provincial government programs, international trade criteria, future commodity price trends, climatic conditions and the financial stability of the borrower.

##### **(k) Transactions with Related Parties**

The Province and the Government of Canada significantly influence the programs delivered by the Corporation and are major contributors to the funding of the programs. Therefore, both governments are considered related parties. All related party transactions with the Province and the Government of Canada have been recorded at the amount of consideration paid or received as agreed to by the related party (see Note 16).

**Agency – continued****Agriculture Financial Services Corporation – Financial Statements 2005-2006****Note 3 Financial Structure****(a) Budget**

The Board of Directors approved the Corporation's budget in August 2004. Contribution from the Province of Alberta of \$276,950 was authorized by the Legislative Assembly and is reflected in the Corporation's budget approved by the Board. The budgeted contribution from the Province of Alberta was adjusted by \$44 for deferred revenue.

**(b) Crop Fund Balance Restriction**

In accordance with the Federal/Provincial Agricultural Policy Framework Implementation Agreement, the crop insurance fund is restricted to being used for crop insurance purposes.

**(c) Other Revenue and Expenses**

The Other column in the Schedule of Revenue, Expense and Surplus includes the wildlife program, the Farm Income Disaster Program and consulting fees and expenses that are not attributable to any of the programs disclosed in the Schedule.

**Note 4 Accounts Receivable**

	2006	2005
Canadian agricultural income stabilization program		
Overpayments and advances	\$123,076	\$105,640
Administration fees	2,439	2,612
Premiums from insured persons		
Crop insurance program	9,917	12,432
Hail insurance program	351	265
Prepaid expenses	617	692
Other	<u>2,085</u>	<u>392</u>
	138,485	122,033
Less allowances for doubtful accounts (Note 13)	<u>(1,382)</u>	<u>(1,129)</u>
	<u>\$137,103</u>	<u>\$120,904</u>

Included in Canadian Agricultural Income Stabilization (CAIS) program overpayments and advances of \$123,076 are \$88,502 in estimated overpayments that are subject to measurement uncertainty. The amount could change substantially in the future if factors considered by management in establishing the estimate for the CAIS program overpayments were to change significantly. The estimate of \$88,502 is for CAIS participants who received advance payments but who have not yet had their final claim processed by the Corporation. The estimate is based on historical experience.

CAIS overpayments are non-interest bearing until December 31, 2006. Participants will receive a rebate if they repay the CAIS overpayment within 90 days of the overpayment notification or they can convert the overpayment to an interest bearing loan up until December 31, 2006. If the overpayment is not repaid or converted to a loan, the Corporation will pursue collection. Collection will include the recovery of the overpayment from future payments under the programs delivered by the Corporation as well as programs administered by the Province of Alberta and Government of Canada.

**Agency – continued****Agriculture Financial Services Corporation – Financial Statements 2005-2006****Note 5 Loans Receivable**

Loans receivable are comprised of the following:

	2006			2005
	Recorded Investment	Specific Allowance	General Allowance	Net Carrying Value
Farm lending	\$815,661	\$ (846)	\$(25,419)	\$789,396
Commercial lending	173,742	(8,358)	(2,805)	162,579
	<u>\$989,403</u>	<u>\$(9,204)</u>	<u>\$(28,224)</u>	951,975
Accrued interest				24,946
Accrued incentives				(2,279)
Loan discounts				(1,558)
				<u>\$973,084</u>
				<u>\$977,460</u>

Impaired loans included in the preceding schedule:

	2006			2005
	Recorded Investment	Specific Allowance	Net Carrying Value	Net Carrying Value
Commercial lending	\$19,852	\$(8,358)	\$11,494	\$ 7,795
Farm lending	6,268	(846)	5,422	3,999
	<u>\$26,120</u>	<u>\$(9,204)</u>	<u>\$16,916</u>	<u>\$11,794</u>

The impaired loans balance includes property held for sale which has been acquired as a result of foreclosures, quit claims and other actions. There is a specific allowance of \$2,688 (2005 \$2,518) on property balances outstanding of \$3,941 (2005 \$3,691).

Loans receivable does not include prepaid balances \$12,609 (2005 \$12,668) which are included in Accounts payable and accrued liabilities.

Included in the above loans receivable balance are loans with concessionary terms which, before discounting, have principal amounts outstanding of:

	2006	2005 (Restated)
Alberta disaster assistance loan program	\$40,239	\$45,048
Alberta farm income disaster loans	21,939	27,628
Indexed deferral plan	668	809
	<u>\$62,846</u>	<u>\$73,485</u>

The prior year concessionary loans were restated because the amounts previously included an amount that did not have concessionary terms.

Loans receivable of \$973,084 is subject to measurement uncertainty. The amount established for specific and general allowances of \$37,428 to cover estimated losses on loans (see Note 2(j)) could change substantially in the future, if factors considered by management in establishing these estimates were to change significantly.

The approximate fair value of loans receivable at March 31, 2006 is \$981,203 (2005 \$967,192). Fair value is based on future cash flows discounted by rates equivalent to the market rates on loans with similar terms and credit risk.



**Agency – continued**  
**Agriculture Financial Services Corporation – Financial Statements 2005-2006**

**Note 6 Investments**

	2006	2005
Bonds and debentures		
Government of Canada, direct and guaranteed	\$141,546	\$124,308
Other provincial direct and guaranteed	<u>15,742</u>	<u>14,293</u>
	157,288	138,601
Corporate securities	<u>78,520</u>	<u>31,075</u>
	235,808	169,676
Accrued interest	<u>2,651</u>	<u>1,553</u>
	<u>\$238,459</u>	<u>\$171,229</u>

The fair value of investments at March 31, 2006 is \$238,183 (2005 \$173,697). Fair value is based on quoted market prices including accrued interest.

**Note 7 Property and Equipment**

	Cost	2006 Accumulated Amortization	Net Book Value	2005 Net Book Value
Software development costs	\$34,448	\$14,980	\$19,468	\$13,459
Building	9,341	1,873	7,468	7,577
Computer equipment	7,958	6,207	1,751	2,064
Equipment and furniture	4,325	2,242	2,083	2,483
Vehicles	1,401	940	461	494
Land and land improvements	<u>799</u>	<u>18</u>	<u>781</u>	<u>670</u>
	<u>\$58,272</u>	<u>\$26,260</u>	<u>\$32,012</u>	<u>\$26,747</u>

Software development costs include \$7,126 (2005 \$3,983) of costs incurred that are not amortized because they are still in the developmental or construction stage.

**Note 8 Estimated Indemnities Payable**

	2006	2005
Canadian agricultural income stabilization program	\$449,222	\$408,064
Crop insurance	6,654	28,761
Wildlife compensation	826	12,573
Hail insurance	<u>181</u>	<u>451</u>
	<u>\$456,883</u>	<u>\$449,849</u>

Estimated indemnities payable of \$449,222 and corresponding contributions and receivables from the Province of Alberta and Government of Canada for the Canadian Agricultural Income Stabilization (CAIS) program are subject to measurement uncertainty because they could change significantly in the future, if factors considered by management in establishing the estimates were to change significantly.

CAIS indemnities payable includes estimated payments for the 2005 claim years of \$318,310 for the vast majority of claims that have not been received yet because the deadline for submission of complete information is after the end of the fiscal year. CAIS program payments are triggered when the participants claim year program margin falls below their support level.

**Agency – continued****Agriculture Financial Services Corporation – Financial Statements 2005-2006**

The two factors impacting estimated indemnities payable for the 2005 claim year are the number of participants and estimated program margins. The estimated number of participants for the 2005 claim year is based on the number of farm operations participating in the program during the 2004 claim year. The estimated program margins are based on forecasted changes in eligible income and expenses and inventories between 2004 and 2005. If the 2005 estimated program margins were to increase by 5%, the estimated indemnities payable for the 2005 claim year would decrease by \$12,000. If the 2005 program margins were to decrease by 5% the estimated indemnities payable for the 2005 claim year would increase by \$14,000.

CAIS indemnities payable includes estimated payments of \$46,010 for claims received but not processed for the 2003 and 2004 claim years. The estimates for the 2003 and 2004 claim years are based on the number of claims received but not yet processed and the estimated average payment per claim.

CAIS indemnities payable for the 2003, 2004 and 2005 claim years also includes estimated payments of \$84,902. The estimate is for claims not yet processed that may receive an increased payment as a result of a change in the method used to determine support levels. The estimate is based on the historical payment ratio for claims processed.

**Note 9 Notes Payable**

Notes payable to the Province of Alberta are comprised of the following:

<b>Remaining Term to Maturity</b>	<b>Effective Interest Rate</b>	<b>2006</b>	<b>Effective Interest Rate</b>	<b>2005</b>
Within 1 year	2.57% - 5.54%	\$ 92,843	2.45% - 5.23%	\$137,050
1 to 5 years	3.75% - 5.93%	263,492	2.57% - 5.54%	189,374
6 to 10 years	4.26% - 7.64%	192,358	4.28% - 7.64%	274,193
Over 10 years	4.43% - 6.52%	335,395	5.04% - 6.52%	298,898
Accrued interest		12,971		11,138
		<u>\$897,059</u>		<u>\$910,653</u>

Net unamortized discounts of \$3,347 (2005 \$3,724) are included in the balances disclosed.

Principal repayments due in each of the next five years are as follows:

Year ending March 31, 2007	\$158,704
2008	\$ 87,629
2009	\$159,688
2010	\$ 56,088
2011	\$110,738

The approximate fair value at March 31, 2006 is \$922,702 (2005 \$950,615). Fair values for notes are based on the net present value of future cash flows. Each individual cash flow payment is discounted at a rate which matches the term of the cash flow payment and is adjusted for a yield premium to reflect several factors. They include the following:

- a liquidity premium to reflect that there is a limited pool of these securities for trading in the market, they would be new to the market and are not direct issues of the Province,
- a factor to reflect the blended payment structure of the notes.

**Agency – continued****Agriculture Financial Services Corporation – Financial Statements 2005-2006****Note 10 Deferred Revenue**

	2006	2005
Government of Canada property and equipment	\$ 8,634	5,221
Premiums from insured persons	7,730	\$10,861
Province of Alberta property and equipment	<u>7,503</u>	<u>5,853</u>
	<u>\$23,867</u>	<u>\$21,935</u>

**Note 11 Reinsurance**

In addition to the protection provided by reinsurance arrangements between the provincial and federal governments, the Corporation has obtained reinsurance from non-government sources. For crop insurance, the Corporation reinsured a maximum of \$113,652 of the risk from non-government sources. For hail insurance, the Corporation reinsured a maximum of \$6,000 of the risk from non-government sources.

**Note 12 Pensions**

The Corporation participates in the multi-employer pension plans, Management Employees Pension Plan and Public Service Pension Plan. The Corporation also participates in the multi-employer Supplementary Retirement Plan for Public Service Managers. The expense for these pension plans is equivalent to the annual contributions of \$2,042 for the year ended March 31, 2006 (2005 \$1,865).

At December 31, 2005, the Management Employees Pension Plan reported a deficiency of \$165,895 (2004 \$268,101) and the Public Service Pension Plan reported a deficiency of \$187,704 (2004 \$450,068). At December 31, 2005, the Supplementary Retirement Plan for Public Service Managers had a surplus of \$10,018 (2004 \$9,404).

**Note 13 Allowances for Doubtful Accounts and for Losses**

	Accounts Receivable (Note 4)	Farm Lending Loans Receivable	Commercial Lending Loans Receivable	Loan Guarantees (Note 14)	Total
Allowances at March 31, 2004	\$1,104	\$31,128	\$12,001	\$1,263	\$45,496
Provision for 2004-05	59	(2,308)	3,921	(77)	1,595
Write-offs in 2004-05, net of recoveries	<u>(34)</u>	<u>(949)</u>	<u>(1,050)</u>	<u>–</u>	<u>(2,033)</u>
Allowances at March 31, 2005	<u>1,129</u>	<u>27,871</u>	<u>14,872</u>	<u>1,186</u>	<u>45,058</u>
Provision for 2005-06	280	(1,111)	(1,684)	(362)	(2,877)
Write-offs in 2005-06, net of recoveries	<u>(27)</u>	<u>(495)</u>	<u>(2,025)</u>	<u>–</u>	<u>(2,547)</u>
Allowances at March 31, 2006	<u>\$1,382</u>	<u>\$26,265</u>	<u>\$11,163</u>	<u>\$ 824</u>	<u>\$39,634</u>

**Note 14 Contingencies and Commitments**

	2006	2005
Loan guarantees	\$29,939	\$34,716
Less allowances for losses (Note 13)	<u>(824)</u>	<u>(1,186)</u>
	29,115	33,530
Legal actions	<u>887</u>	<u>692</u>
Total contingencies	<u>\$30,002</u>	<u>\$34,222</u>

**Agency – continued****Agriculture Financial Services Corporation – Financial Statements 2005-2006****Note 14** Contingencies and Commitments (continued)

The majority of loan guarantees relate to loans made by other financial institutions with repayment guaranteed by the Corporation under the Alberta Farm Development Loans program. The loans outstanding at March 31, 2006 made by other financial institutions were \$47,581 (2005 \$52,788). Loan guarantees under the Alberta Farm Development Loans program include the maximum liability on loan guarantees of \$18,964 (2005 \$23,153) to which the Corporation is exposed under the terms of the agreements with the financial institutions subject to recoveries on underlying securities.

Legal actions represent amounts claimed or amounts claimed in excess of what was accrued. The outcome of the legal actions is not determinable at this time.

The Corporation has a contingent liability in respect of a claim concerning the methodology used to calculate pension benefit payments under Public Service Pension Plan. The claim has been filed jointly and severally against the Province of Alberta and the employers including those participating in the Public Service Pension Plan. The claim specified an amount of \$1,250,000. The Corporation is one out of 587 entities included in the claim and the Corporation's share of liability is not determinable.

	2006	2005
Approved, undisbursed loans	\$36,914	\$42,861
Reinsurance	15,500	15,615
Estimated farm loan incentives	15,569	14,612
Operating leases	1,003	1,371
Building costs	–	217
Total commitments	<u>\$68,986</u>	<u>\$74,676</u>

The operating lease commitments are for accommodations with terms up to five years.

**Note 15 Credit Risk and Interest Risk****(a) Credit Risk**

Credit risk is the risk that a debtor may not pay amounts owing thus resulting in a loss.

The following table provides a breakdown of the loan receivables by sector. This analysis provides an indication of the concentration of credit risk on the loan portfolio. Significant information is provided throughout these statements to disclose other concentrations of credit risk.

	2006	2005
Loans receivable by sector		
Grain	\$ 408,360	\$ 410,817
Beef	324,530	320,280
Accommodation and food services	22,935	29,769
Trade – retail and wholesale	32,317	28,438
Hog	25,700	27,860
Manufacturing	29,060	24,713
Processors/feedmills	4,221	7,767
Other	163,389	170,559
	<u>1,010,512</u>	<u>1,020,203</u>
Allowance	<u>(37,428)</u>	<u>(42,743)</u>
	<u>\$ 973,084</u>	<u>\$ 977,460</u>

**Agency – continued****Agriculture Financial Services Corporation – Financial Statements 2005-2006****Note 15** Credit Risk and Interest Risk (continued)**(b) Interest Risk**

Interest rate risk is the impact future changes of interest rates have on cash flows and fair value of assets and liabilities. The following provides a breakdown of the gaps between the notes payable and the loan portfolio. Because there are no early repayment penalties on most loan programs, the gap analysis includes an adjustment for expected repayments based on historical patterns.

	Term to Maturity <sup>(1)</sup>				Not Interest Rate Sensitive <sup>(2)</sup>	2006 Total	2005 Total
	Within 1 Year	1 to 5 Years	6 to 10 Years	Over 10 Years			
Farm loans	\$ 71,212	\$266,913	\$235,956	\$240,743	\$ (4,492)	\$810,332	\$812,138
Yield <sup>(3)</sup>	6.85%	6.53%	6.63%	6.25%	–	6.59%	6.87%
Commercial loans	\$ 56,561	\$ 94,032	\$ 12,345	\$ –	\$ (186)	\$162,752	\$165,322
Yield <sup>(3)</sup>	7.00%	7.11%	5.39%	–	–	6.94%	7.17%
Total	\$127,773	\$360,945	\$248,301	\$240,743	\$ (4,678)	\$973,084	\$977,460
Yield <sup>(3)</sup>	6.87%	6.57%	6.61%	6.25%	–	6.61%	6.89%
Notes payable Province of Alberta	\$158,704	\$414,143	\$222,144	\$ 92,444	\$ 9,624	\$897,059	\$910,653
Yield <sup>(3)</sup>	5.34%	5.35%	5.33%	5.20%	–	5.34%	5.50%
Net gap before prepayment adjustment	\$(30,931)	\$(53,198)	\$ 26,157	\$148,299	\$(14,302)	\$ 76,025	\$ 66,807
Estimated prepayment	42,957	72,475	(23,375)	(92,057)	–	–	–
Net gap	\$ 12,026	\$ 19,277	\$ 2,782	\$ 56,242	\$(14,302)	\$ 76,025	\$ 66,807

The gap positions represent the mismatching of the financing with the loan portfolio at March 31, 2006. The gaps provide an indication of the potential risks to the Corporation if interest rates change. At March 31, 2006 an immediate and sustained increase in interest rates of 1% would increase the net fair market value of loans and financing for the next fiscal year by \$8,129 based on the net gap before prepayment adjustment. A corresponding decrease in interest rates would decrease the net fair market value of loans and financing by a similar amount over the same period.

This gap analysis does not include the investment portfolio, which is disclosed separately below. Investments are not included because investments relate to insurance program cash flows which are managed separately from lending program cash flows.

**Agency – continued****Agriculture Financial Services Corporation – Financial Statements 2005-2006****Note 15** Credit Risk and Interest Risk (continued)

The following provides a breakdown of the investment portfolio by term to maturity.

	Term to Maturity <sup>(1)</sup>				2006 Total	2005 Total
	Within 1 Year	1 to 5 Years	6 to 10 Years	Over 10 Years		
Bonds and debentures	\$22,487	\$116,610	\$10,153	\$8,038	\$157,288	\$138,601
Yield <sup>(3)</sup>	3.70%	3.84%	4.65%	5.64%	3.96%	3.98%
Corporate securities	–	37,451	41,069	–	78,520	31,075
Yield <sup>(3)</sup>	–	4.46%	4.45%	–	4.46%	5.15%
	22,487	154,061	51,222	8,038	235,808	169,676
Accrued interest	180	1,435	936	100	2,651	1,553
	<u>\$22,667</u>	<u>\$155,496</u>	<u>\$52,158</u>	<u>\$8,138</u>	<u>\$238,459</u>	<u>\$171,229</u>

(1) For loans, term to maturity reflects the period of time until an interest rate renegotiation date or the maturity date of the loan. For notes payable, term to maturity reflects the contractual maturity date of the debt. The interest rates are fixed until maturity. Repayment is either by semi-annual, annual installments or full repayment at maturity of principal. For investments, term to maturity classifications are based on contractual maturity date of the security.

(2) Includes general provisions, accrued interest, accrued beginning farmer incentive and unamortized loan discount.

(3) For notes payable and investments, yield represents the rate which discounts future cash receipts to the carrying amount. For loans, yield represents the rate which discounts the stream of future payments from the reporting date to the next interest rate renegotiation date or the rate which discounts future cash receipts to the carrying amount.

**Note 16** Related Party Transactions

Sufficient information is provided throughout these statements to disclose significant related party transactions the Corporation entered into, except for the following:

	2006	2005
Interest expense – Province of Alberta	\$44,849	\$45,057
Administration expense – Province of Alberta	1,586	1,864
Administration expense – Government of Canada	374	271

**Note 17** Crop Reinsurance Funds

The contributions, withdrawals and accumulated deficit positions of the Crop Reinsurance Fund of Alberta and Crop Reinsurance Fund of Alberta for Canada are as follows (see Note 2(f)):

	Crop Reinsurance Fund of Alberta		Crop Reinsurance Fund of Canada for Alberta	
	2006	2005	2006	2005
Opening surplus (deficit)	\$ 2,843	\$(20,819)	\$(29,828)	\$(61,841)
Contributions	11,556	23,662	45,093	32,013
Closing surplus (deficit)	<u>\$14,399</u>	<u>\$ 2,843</u>	<u>\$ 15,265</u>	<u>\$(29,828)</u>

**Note 18** Comparative Figures

The 2005 figures have been reclassified where necessary to conform to 2006 presentation.

**Agency – continued**  
**Agriculture Financial Services Corporation – Schedule of Revenue, Expense and Surplus for the Year Ended March 31, 2006**

**Schedule 1**  
*(in thousands)*

	2006	2005	2006	2005	2006	2005
	Canadian	Canadian				
	Agricultural	Agricultural				
	Income	Income				
	Stabilization	Stabilization				
			Crop	Crop	Lending	Lending
			Insurance	Insurance		
Revenue						
Premiums from insured persons	\$ -	\$ -	\$116,968	\$115,047	\$ -	\$ -
Interest	3	3	435	363	68,110	70,806
Contribution from Province of Alberta	288,900	202,160	171,628	86,928	8,210	8,146
Contribution from Government of Canada	195,710	293,483	95,818	115,307	-	-
Investment income	1,431	763	10,017	5,957	449	310
Fees and other income	2,008	2,608	47	62	1,929	2,192
Reinsurance recoveries	-	-	-	-	-	-
	<u>488,052</u>	<u>499,017</u>	<u>394,913</u>	<u>323,664</u>	<u>78,698</u>	<u>81,454</u>
Expense						
Indemnities	472,366	487,887	147,013	156,877	-	-
Reinsurance	-	-	58,011	44,469	-	-
Administration (Schedule 2)	15,686	11,130	18,454	20,670	22,218	25,719
Interest	-	-	39	-	44,849	45,057
Adjusting	-	-	6,447	7,206	-	-
Farm loan incentives	-	-	-	-	4,863	5,077
(Recovery) provision for doubtful accounts and for losses (Note 13)	-	-	262	30	(3,157)	1,557
Selling commissions	-	-	-	-	-	-
	<u>488,052</u>	<u>499,017</u>	<u>230,226</u>	<u>229,252</u>	<u>68,793</u>	<u>77,410</u>
Surplus (deficit) for the year	-	-	164,687	94,412	9,905	4,044
Surplus at beginning of year	-	-	184,976	90,564	61,638	57,594
Surplus at end of year	<u>\$ -</u>	<u>\$ -</u>	<u>\$349,663</u>	<u>\$184,976</u>	<u>\$71,543</u>	<u>\$61,638</u>

**Agency – continued**  
**Agriculture Financial Services Corporation – Schedule of Revenue, Expense and Surplus for the Year Ended March 31, 2006**

**Schedule 1 – continued**  
*(in thousands)*

	2006 Hail Insurance	2005 Hail Insurance	2006 Other	2005 Other	2006 Total	2005 Total
Revenue						
Premiums from insured persons	\$24,556	\$ 20,894	\$ –	\$ –	\$141,524	\$135,941
Interest	77	57	11	13	68,636	71,242
Contribution from Province of Alberta	–	–	(705)	22,688	468,033	319,922
Contribution from Government of Canada	–	–	(610)	22,588	290,918	431,378
Investment income	2,331	2,992	–	–	14,228	10,022
Fees and other income	421	309	370	203	4,775	5,374
Reinsurance recoveries	10	2,163	–	–	10	2,163
	<u>27,395</u>	<u>26,415</u>	<u>(934)</u>	<u>45,492</u>	<u>988,124</u>	<u>976,042</u>
Expense						
Indemnities	21,722	32,281	(2,117)	43,391	638,984	720,436
Reinsurance	548	420	–	–	58,559	44,889
Administration (Schedule 2)	1,415	1,323	328	1,177	58,101	60,019
Interest	1	–	138	590	45,027	45,647
Adjusting	525	569	674	297	7,646	8,072
Farm loan incentives	–	–	–	–	4,883	5,077
(Recovery) provision for doubtful accounts and for losses (Note 13)	18	8	–	–	(2,877)	1,595
Selling commissions	2,233	2,027	–	–	2,233	2,027
	<u>26,462</u>	<u>36,628</u>	<u>(977)</u>	<u>45,455</u>	<u>812,556</u>	<u>887,762</u>
Surplus (deficit) for the year	933	(10,213)	43	37	175,568	88,280
Surplus at beginning of year	39,658	49,871	541	504	286,813	198,533
Surplus at end of year	<u>\$40,591</u>	<u>\$ 39,658</u>	<u>\$ 584</u>	<u>\$ 541</u>	<u>\$462,381</u>	<u>\$286,813</u>



**Agency – continued****Agriculture Financial Services Corporation – Schedule of Administration Expense for the Year Ended March 31, 2006****Schedule 2***(in thousands)*

	<b>2006 Budget (Note 3(a))</b>	<b>2006 Actual</b>	<b>2005 Actual</b>
Salaries and benefits (Note 12)	\$38,019	\$33,904	\$37,581
Contracted services	7,881	8,765	7,210
Amortization of capital assets	4,700	5,301	4,501
Office accommodation costs	3,222	3,017	3,050
Stationery and supplies	941	1,418	1,645
Data processing	812	1,310	1,165
Travel and automobile	1,088	705	795
Advertising	1,210	699	902
Telecommunications	772	615	724
Postage and freight	604	481	554
Training, meetings, seminars, conferences	596	478	378
Professional services	611	443	613
Directors' fees and expenses	479	413	401
Equipment, rental and maintenance	472	412	360
Miscellaneous	144	140	140
	<u>\$61,551</u>	<u>\$58,101</u>	<u>\$60,019</u>

**Agency – continued****Agriculture Financial Services Corporation – Schedule of Salaries and Benefits for the Year Ended March 31, 2006****Schedule 3***(in thousands)*

	2006			2005	
	Base Salary <sup>(1)</sup>	Other Cash Benefits <sup>(2)</sup>	Other Non-cash Benefits <sup>(3)</sup>	Total	Total
Chairman of Board	\$ 72	\$ –	\$ –	\$ 72	\$ 78
Board members <sup>(4)</sup>	233	–	–	233	233
President and Managing Director	189	56	36	281	184
Executive/Vice-Presidents					
Vice-President, Finance	149	23	32	204	184
Vice-President, Lending Operations	142	21	31	194	218
Vice-President, Risk Management <sup>(5)</sup>	143	33	31	207	49

<sup>(1)</sup> Base salaries are fees for Chair and Board members and base pay for employees.

<sup>(2)</sup> Other cash benefits include bonuses and lump sum payments.

<sup>(3)</sup> Other non-cash benefits include employer's share of all employee benefits, including health care, dental and vision care allowance, group life insurance benefits, pensions, employment insurance, accidental death/dismemberment and long-term disability insurance, workers' compensation and professional memberships. No amount is included in other non-cash benefits for an automobile provided to the President and Managing Director.

<sup>(4)</sup> The amounts relate to eight Board members during 2005/06 (eight in 2004/05).

<sup>(5)</sup> This position was created effective January 1, 2005.