

# MIDDLEBURY NATIONAL CORPORATION

30 Main Street, P.O. Box 189, Middlebury, Vermont 05753-0189

April 8, 2008

## NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

To Our Shareholders:

**NOTICE IS HEREBY GIVEN** that, pursuant to the call of its Directors, the Annual Meeting of Shareholders of the Middlebury National Corporation will be held at The Middlebury Inn, Middlebury, Vermont, on Tuesday, May 6, 2008, at 2:00 p.m. for the following purposes:

1. Election of three (3) Directors to serve until the 2011 Annual Meeting of Shareholders
2. To ratify the appointment of A.M. Peisch & Company, LLP, independent auditors, to serve as auditors for the Corporation for the year 2008
3. To transact any other business that may properly come before the meeting or any adjournment thereof

The close of business March 26, 2008, has been fixed as a record date for determining shareholders entitled to notice of a vote at the Annual Meeting.

By order of the Board of Directors,



Sarah D. Stahl  
President

# MIDDLEBURY NATIONAL CORPORATION

30 Main Street, P.O. Box 189, Middlebury, Vermont 05753-0189

## PROXY STATEMENT ANNUAL MEETING OF SHAREHOLDERS MAY 6, 2008

This proxy statement is furnished in connection with the solicitation of proxies by or on behalf of the Directors of the Middlebury National Corporation for use at the Annual Meeting of Shareholders to be held on Tuesday, May 6, 2008, at 2:00 p.m. at The Middlebury Inn, Middlebury, Vermont, or any adjournment thereof.

A proxy duly executed and returned by the shareholder will be voted as directed by the proxy. If no choice is specified, the proxy will be voted for the election of nominees set forth in the proxy. If other matters are voted upon, persons named in the proxy will take action in accordance with the recommendations of management. Any proxy may be revoked by written notice to the Secretary of the Corporation prior to the voting of the proxy.

### ELECTION OF DIRECTORS

As provided for in the Articles of Association, the Board is divided into three classes of directors: Class I, Class II, and Class III, so that approximately one third of the directors' terms expire each year. Directors whose terms expire at the 2008 Shareholders' Meeting are Fletcher R. Brush, Linda K. Harmon, and Roch F. MacIntyre. All will stand for re-election to hold office until the year 2011 Shareholders' Meeting. The Board of Directors recommends a vote "FOR" the Election of Directors.

The persons listed below constitute the total members of the Board of Directors.

Name	Age	Position with Middlebury National Corporation and Principal Occupation	Director Since	Term Expires	Shares Beneficially Owned
<b>Class I Directors</b>					
Paul J. Carrara, Jr.	38	Director of Middlebury National Corporation and National Bank of Middlebury; Project Manager, JP Carrara & Sons, Inc., Middlebury, Vermont.	2002	2010	1160
Lawrence W. Miller, II	41	Director of Middlebury National Corporation and National Bank of Middlebury; Financial Consultant; CEO of Danforth Pewterers, Middlebury, Vermont	2004	2010	152
G. Kenneth Perine	56	Director of Middlebury National Corporation and National Bank of Middlebury; Executive Vice President, Middlebury National Corporation; President, National Bank of Middlebury, Middlebury, Vermont.	1990	2010	1730

Name	Age	Position with Middlebury National Corporation and Principal Occupation	Director Since	Term Expires	Shares Beneficially Owned
<b>Class II Directors</b>					
Fletcher R. Brush	58	Director of Middlebury National Corporation and National Bank of Middlebury; Customer Relations Manager, Co-Operative Insurance Companies, Middlebury, Vermont.	2008	2008	50
Linda K. Harmon	58	Director of Middlebury National Corporation and National Bank of Middlebury; President, H&M Mountain Enterprises, Inc., dba Mary's at Baldwin Creek, Bristol, Vermont.	1995	2008	450
Roch F. MacIntyre	63	Director of Middlebury National Corporation and National Bank of Middlebury; Manager, MacIntyre Services, LLC, Middlebury, Vermont.	1980	2008	4614
<b>Class III Directors</b>					
Caroline R. Carpenter	42	Director of Middlebury National Corporation and National Bank of Middlebury; Executive Vice President and Information Technology Manager, National Bank of Middlebury, Middlebury, VT	2005	2009	694
John M. McCardell, Jr.	58	Director of Middlebury National Corporation and National Bank of Middlebury; Chairman, National Bank of Middlebury; President Emeritus, Middlebury College; Professor of History, Middlebury College, Middlebury, VT	1992	2009	1,000
Sarah D. Stahl	58	Director of Middlebury National Corporation and National Bank of Middlebury; President, Middlebury National Corporation; Operations Manager, Vermont Folklife Center, Middlebury, VT	1988	2009	380

#### REMUNERATION OF MANAGEMENT

Directors and officers were compensated as directors and officers of the bank, and received no compensation for their position in the holding company. All directors attended at least 75% of board meetings held in 2007. The aggregate compensation paid during 2007 to seven outside directors was \$90,375. The aggregate compensation paid to the seventeen officers was \$1,231,133. The aggregate cost for contributions to the officers' retirement plan accounts was \$221,878.

#### APPROVAL OF INDEPENDENT AUDITORS

A.M. Peisch & Company, LLP, a certified public accounting firm with five offices in Vermont, has been independent auditor for the Middlebury National Corporation since its organization in 1985 and for The National Bank of Middlebury many years prior to 1985. The Board of Directors recommends a vote "FOR" the appointment of A.M. Peisch & Company, LLP, as independent auditors for the year 2008.

#### OTHER MATTERS

As of the date of the notice of meeting, the Board of Directors knows of no other business that may come before the meeting except as set forth above. If other matters should properly come before the meeting, it is expected that proxies will be voted on such matters in accordance with the recommendations of management.

## INDEPENDENT AUDITOR'S REPORT

To the Board of Directors  
and Shareholders of  
Middlebury National Corporation  
Middlebury, Vermont

We have audited the accompanying consolidated balance sheets of Middlebury National Corporation and Subsidiary (National Bank of Middlebury) as of December 31, 2007 and 2006, and the related consolidated statements of income, changes in shareholders' equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with U.S. generally accepted auditing standards. 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. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Middlebury National Corporation and Subsidiary as of December 31, 2007 and 2006, and the results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

*A. M. Peisch & Company, LLP*

January 31, 2008  
Rutland, Vermont  
VT Reg. No 92-0000102

**MIDDLEBURY NATIONAL CORPORATION AND SUBSIDIARY**  
**CONSOLIDATED BALANCE SHEETS**  
**December 31, 2007 and 2006**

	2007	2006
<b>ASSETS</b>		
Cash and cash equivalents	\$5,079,271	\$6,768,157
Interest bearing balances due from FHLBB and other financial institutions	140,469	116,524
Federal funds sold	7,669,000	1,120,000
Securities held-to-maturity (market value of \$2,742,546 in 2007 and \$3,579,687 in 2006)	2,706,092	3,576,883
Securities available-for-sale	35,254,702	41,031,173
Restricted equity securities	1,541,100	1,564,700
Mortgage loans held for sale	-0-	130,000
Loans, net	156,045,384	147,360,491
Bank premises and equipment, net	7,178,038	6,265,395
Accrued interest receivable	1,056,531	1,100,301
Bank owned life insurance	4,658,082	4,471,184
Other assets	3,286,665	2,878,107
Total assets	<b>\$224,615,334</b>	<b>\$216,382,915</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>LIABILITIES</b>		
Deposits:		
Demand	\$ 23,649,723	\$ 23,486,765
NOW	66,055,844	60,627,598
Savings and money market	47,391,550	50,028,044
Time \$100,000 and over	17,165,612	8,994,593
Other time	27,558,378	29,051,579
Total deposits	181,821,107	172,188,579
Borrowed funds	10,088,971	12,108,245
Securities sold under agreements to repurchase	9,320,928	10,392,998
Other liabilities	1,871,223	1,687,165
Total liabilities	203,102,229	196,376,987
<b>COMMITMENTS AND CONTINGENCIES</b>		
<b>SHAREHOLDERS' EQUITY</b>		
Common stock, no par value 1,200,000 shares authorized, 960,000 shares issued	400,000	400,000
Surplus	1,000,000	1,000,000
Retained earnings	20,722,333	19,638,168
Accumulated other comprehensive income (loss)	3,328	(419,684)
Less: Treasury stock at cost (69,848 shares in 2007 and 2006)	(612,556)	(612,556)
Total shareholders' equity	21,513,105	20,005,928
Total liabilities and shareholders' equity	<b>\$224,615,334</b>	<b>\$216,382,915</b>

*See notes to Consolidated Financial Statements.*

**MIDDLEBURY NATIONAL CORPORATION AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF INCOME**  
**Years ended December 31, 2007 and 2006**

	2007	2006
Interest income		
Interest and fees on loans	\$10,823,681	\$10,105,311
Interest and dividends on securities		
Mortgage-backed securities	923,384	907,192
U.S. Government agencies	183,882	276,298
Corporate debt	192,307	271,119
States and political subdivisions	509,091	539,862
Other securities	103,917	101,319
Interest on federal funds sold and FHLBB balances	199,348	187,240
Total interest income	12,935,610	12,388,341
Interest expense		
Interest on time \$100,000 and over	547,624	326,422
Interest on other deposits	2,885,346	2,380,263
Interest on borrowings	927,776	1,088,801
Total interest expense	4,360,746	3,795,486
Net interest income	8,574,864	8,592,855
Less: provision for loan losses	-0-	-0-
Net interest income after provision for loan losses	8,574,864	8,592,855
Other operating income		
Service charges on deposit accounts	395,595	369,780
Other service charges, collection and exchange	631,754	578,922
Gain on sale of loans - Net	200,665	146,260
Income from bank owned life insurance	186,898	185,265
Other	204,705	209,419
Total other operating income	1,619,617	1,489,646
Other operating expenses		
Salaries	3,338,871	3,054,245
Pension and other employee benefits	1,207,837	1,132,714
Occupancy expense	640,031	593,907
Equipment expense	508,274	514,295
Other	2,501,225	2,361,521
Total other operating expenses	8,196,238	7,656,682
Income before income taxes	1,998,243	2,425,819
Income tax expense	246,464	470,324
Net income	\$ 1,751,779	\$ 1,955,495
Earnings per share	\$1.97	\$2.20

*See notes to Consolidated Financial Statements.*

**MIDDLEBURY NATIONAL CORPORATION AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**  
**Years ended December 31, 2007 and 2006**

	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
<b>Balance, December 31, 2005</b>	\$400,000	\$1,000,000	\$18,314,680	\$(526,119)	\$(612,556)	\$18,576,005
Comprehensive income						
Net Income	-0-	-0-	1,955,495	-0-	-0-	1,955,495
Other comprehensive income, net of tax						
Net changes in unrealized loss on securities available- for-sale - Net of tax \$54,831	-0-	-0-	-0-	106,435	-0-	<u>106,435</u>
Total comprehensive income	-0-	-0-	-0-	-0-	-0-	<u>2,061,930</u>
Cash dividends declared (\$ .71 per share)	-0-	-0-	( 632,007 )	-0-	-0-	(632,007)
<b>Balance, December 31, 2006</b>	\$400,000	\$1,000,000	\$19,638,168	\$(419,684)	\$(612,556)	\$20,005,928
Comprehensive income						
Net Income	-0-	-0-	1,751,779	-0-	-0-	1,751,779
Other comprehensive income, net of tax						
Net changes in unrealized gain (loss) on securities available- for-sale - Net of tax \$217,915	-0-	-0-	-0-	423,012	-0-	<u>423,012</u>
Total comprehensive income	-0-	-0-	-0-	-0-	-0-	<u>2,174,791</u>
Cash dividends declared (\$ .75 per share)	-0-	-0-	(667,614)	-0-	-0-	(667,614)
<b>Balance, December 31, 2007</b>	\$400,000	\$ 1,000,000	\$20,722,333	\$ 3,328	\$(612,556)	\$21,513,105

*See notes to Consolidated Financial Statements.*

**MIDDLEBURY NATIONAL CORPORATION AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**Years ended December 31, 2007 and 2006**

	2007	2006
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$1,751,779	\$1,955,495
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	473,650	450,157
Provision for possible loan losses	-0-	-0-
Provision for deferred taxes	(19,639)	(75,529)
Decrease in accrued income tax	(124,571)	(51,506)
Decrease (increase) in interest receivable	43,770	(51,933)
Net amortization	23,838	74,817
Increase in interest payable	6,373	14,185
Increase in bank owned life insurance	(186,898)	(185,265)
Change in other - Net	(304,578)	(141,787)
Decrease (increase) in mortgage loans held-for-sale	130,000	(130,000)
Loss on disposal of assets	-0-	16,237
Gain on sale of loans	(200,665)	(146,260)
Net cash provided by operating activities	1,593,059	1,728,611
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Securities held-to-maturity		
Maturities/paydowns	862,300	1,721,700
Securities available-for-sale		
Sales, maturities, and paydowns	9,337,051	15,430,719
Purchases	(2,935,000)	(3,120,838)
Sales (purchases) of restricted equity securities	23,600	(187,000)
Net change in federal funds and interest bearing balances	(6,572,945)	354,434
Net increase in loans	(8,484,228)	(7,977,076)
Capital acquisitions	(1,386,293)	(1,648,877)
Net cash used in investing activities	(9,155,515)	(5,426,938)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net increase (decrease) in demand deposits, NOW accounts and savings accounts	2,954,710	(2,209,840)
Net increase in certificates of deposit	6,677,818	1,428,957
(Decrease) increase in securities sold under agreement	(1,072,070)	3,074,152
(Decrease) increase in borrowed funds	(2,019,274)	1,982,080
Dividend payments	(667,614)	(632,007)
Net cash provided by financing activities	5,873,570	3,643,342
Net decrease in cash and cash equivalents	(1,688,886)	(54,985)
Cash and cash equivalents		
Beginning	6,768,157	6,823,142
Ending	\$5,079,271	\$6,768,157

(Continued)

**MIDDLEBURY NATIONAL CORPORATION AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS** *(continued)*  
**Years ended December 31, 2007 and 2006**

	<b>2007</b>	<b>2006</b>
<b>SUPPLEMENTAL SCHEDULE OF CASH FLOW INFORMATION</b>		
Cash payments for:		
Interest	\$4,354,373	\$3,781,301
Income taxes	\$ 402,698	\$ 597,399

**SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING  
AND FINANCING ACTIVITIES**

Unrealized gain on securities available-for-sale	\$ 640,927	\$ 161,266
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*See notes to Consolidated Financial Statements.*

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1. Significant Accounting Policies**

The accounting policies of Middlebury National Corporation and Subsidiary are in conformity with U.S. generally accepted accounting principles and general practices within the banking industry. The following is a description of the more significant policies.

**Basis of consolidation**

The consolidated financial statements include the accounts of Middlebury National Corporation (Company) and the National Bank of Middlebury (Bank), its wholly owned subsidiary. All significant intercompany accounts have been eliminated.

**Nature of operations**

Middlebury National Corporation is a one bank holding company located in Middlebury, Vermont. Its subsidiary, National Bank of Middlebury, provides a variety of financial services to individuals and business customers through its five branches in central Vermont, which is primarily a small business and manufacturing area. The Bank's primary deposit products are checking and savings accounts and certificates of deposit. Its primary lending products are commercial, real estate and consumer loans.

**Concentration of risk**

The Company's operations are affected by various risk factors, including interest rate risk, credit risk and risk from geographic concentration of lending activities. Management attempts to manage interest rate risk through various asset/liability management techniques designed to match maturities of assets and liabilities. Loan policies and administration are designed to provide assurance that loans will only be granted to credit worthy borrowers, although credit losses are expected to occur because of subjective factors and factors beyond the control of the Company. Although the Company has a diversified loan portfolio and economic conditions are stable, most of its lending activities are conducted within the geographic area where it is located. As a result, the Company and its borrowers may be especially vulnerable to the consequences of changes in the local economy. Note 2 discusses the types of investments the Company invests in, and Note 4 discusses the type of lending the Company engages in.

**Use of estimates**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant changes relate to the determination of the allowance for losses on loans. In connection with the determination of the allowance for losses on loans, management obtains independent appraisals for significant properties. Accordingly, the ultimate collectibility of a substantial portion of the Company's loan portfolio is susceptible to changes in local market conditions.

**Note 1. Significant Accounting Policies** *(continued)*

While management uses available information to recognize losses on loans, future additions to the allowances may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for losses on loans. Such agencies may require the Bank to recognize additions to the allowance based on their judgments about information available to them at the time of their examination.

**Presentation of cash flows**

For the purpose of presentation in the Statements of Cash Flows, the Company considers cash and due from banks to be cash equivalents.

**Investment securities**

Debt securities the Company has the positive intent and ability to hold to maturity are classified as held-to-maturity and reported at amortized cost adjusted for amortization of premiums and accretion of discounts using methods approximating the interest method. Debt and equity securities purchased and held primarily for resale in the near future are classified as trading. Trading securities are carried at fair value with unrealized gains and losses included in earnings. Debt and equity securities not classified as either held-to-maturity or trading are classified as available-for-sale. Investments classified as available-for-sale are carried at market value with unrealized gains and losses reported as a net amount in other comprehensive income net of tax. The specific identification method is used to determine realized gains and losses on sales of securities available-for-sale.

Declines in the fair value of individual held-to-maturity and available-for-sale securities below their cost that are other than temporary result in write-downs of the individual securities to their fair value. The related write downs are included in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

**Restricted equity investments**

As a member of the Federal Home Loan Bank of Boston (FHLBB) and the Federal Reserve Bank of Boston, the Company is required to invest in their stock. The stock is nonmarketable, and when redeemed, the Company would receive from the FHLBB and the Federal Reserve Bank of Boston an amount equal to the par value of the stock.

**Loans**

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at the amount of unpaid principal, reduced by an allowance for loan losses and unearned fees. Mortgage loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value in the aggregate.

Sales are made with limited recourse. Net unrealized losses are recognized through a valuation allowance by charges to income. Loan interest income is accrued daily on the outstanding balances. Accrual of interest is discontinued when a loan is specifically determined to be impaired or when the loan is delinquent 90 days and management believes, after considering collection efforts and other factors that the borrower's financial condition is such that collection of interest is doubtful. Any unpaid interest previously accrued on those loans is removed from income. Interest income generally is not recognized on specific impaired loans unless the likelihood of further loss is remote. Interest payments received on such loans are generally applied as a reduction of the loan principal balance. Interest income on other nonaccrual loans is recognized only to the extent of interest payments received. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. Loans are charged off when collection of principal is considered doubtful.

Loan origination and commitment fees and certain direct loan origination costs are being deferred and amortized as an adjustment of the related loans' yield. The Bank is generally amortizing these amounts over the contractual life.

**Allowance for loan losses**

The allowance for loan losses is maintained at a level, which, in management's judgment, is adequate to absorb credit losses inherent in the loan portfolio. The amount of the allowance is based on management's evaluation of the collectibility of the loan portfolio, including the nature of the portfolio, credit concentrations, trends in historical loss experience, specific impaired loans, and economic conditions. Allowances for impaired loans are generally determined based on collateral values or the present value of estimated cash flows. Although management uses available

**Note 1. Significant Accounting Policies** *(continued)*

information to recognize losses on loans, because of uncertainties associated with local economic conditions, collateral values, and future cash flows on impaired loans, it is reasonably possible that a material change could occur in the allowance for loan losses in the near term. However, the amount of the change that is reasonably possible cannot be estimated. The allowance is increased by a provision for loan losses, which is charged to expense, and reduced by charge-offs, net of recoveries. Past due status is determined on a contractual basis.

**Bank premises and equipment**

Bank premises and equipment are stated at cost, less an allowance for depreciation. The provision for depreciation is computed primarily on the straight-line method over the estimated useful lives of the related assets. The cost of assets sold or otherwise disposed of, and the related allowance for depreciation, are eliminated from the accounts and the resulting gains or losses are reflected in the income statement. Maintenance and repairs are charged to current expenses as incurred and the cost of major renewals and improvements are capitalized.

**Mortgage servicing**

The Bank recognizes as separate assets, rights to service mortgage loans for others, however those servicing rights are acquired. When the Bank acquires mortgage servicing rights through either the purchase or origination of mortgage loans (originated mortgage servicing rights) and sells or securitizes those loans with servicing rights retained, it allocates the total cost of the mortgage loans to the mortgage servicing rights and the loans (without the mortgage servicing rights) based on their relative fair values. To determine the fair value of the servicing rights created, the Bank uses the market prices under comparable servicing sale contracts. The cost of mortgage servicing rights is amortized in proportion to, and over the period of, estimated net servicing revenues. Impairment of mortgage servicing rights is assessed based on the fair value of those rights. Fair values are estimated using discounted cash flows based on a current market interest rate.

**Income taxes**

The Company recognizes income taxes under the asset and liability method. Under this method, net deferred tax assets and liabilities are established for the temporary differences between the accounting basis and the tax basis of the Company's assets and liabilities at tax rates expected to be in effect when the amounts related to such temporary differences are realized or settled. Adjustments to the Company's deferred tax assets are recognized as deferred income tax expense or benefit based on management's judgments relating to the realizability of such assets. The Company files a consolidated tax return with its subsidiary.

**Other real estate owned**

Real estate properties acquired through or in lieu of loan foreclosure are initially recorded at the lower of the Bank's carrying amount or fair value less estimated selling cost at the date of foreclosure. Any write-downs based on the asset's fair value at the date of acquisition are charged to the allowance for loan losses. After foreclosure, these assets are carried at the lower of their new cost basis or fair value less cost to sell. Costs of significant property improvements are capitalized, whereas costs relating to holding property are expensed. Valuations are periodically performed by management, and any subsequent write-downs are recorded as a charge to operations, if necessary, to reduce the carrying value of a property to the lower of its costs or fair value less cost to sell.

**Off-balance-sheet financial instruments**

In the ordinary course of business the Company has entered into off-balance-sheet financial instruments consisting of commitments to extend credit, commercial letters of credit, and standby letters of credit. Such financial instruments are recorded in the financial statements when they become payable.

**Earnings per share**

Earnings per share are computed using the weighted average number of shares of common stock outstanding during the year, which was 890,152 shares for 2007 and 2006.

**Fair value of financial instruments**

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

**Cash and due from banks:** The carrying amounts reported in the balance sheet for cash and due from banks approximate those assets' fair values.

**Note 1. Significant Accounting Policies** *(continued)*

**Investment securities:** Fair values for investment securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments. The carrying amounts of FHLBB and Federal Reserve Bank of Boston stock approximates fair value.

**Loans and loans held for sale:** For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying amounts. The fair values of other loans (for example, fixed rate commercial real estate and rental property mortgage loans and commercial and industrial loans) are estimated using discounted cash flow analysis, based on interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Loan fair value estimates include judgments regarding future expected loss experience and risk characteristics.

**Deposits:** The fair values disclosed for demand deposits (for example, checking and savings accounts) are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The fair values for certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated contractual maturities on such time deposits.

**Repurchase agreements and borrowed funds:** For repurchase agreements and borrowed funds (including federal funds purchased) that reprice frequently, fair values are based on carrying amounts. The fair values for other borrowings are estimated using a discounted cash flow calculation that applies interest rates currently being offered on such debt to a schedule of aggregated contractual maturities on such debt.

**Accrued interest:** The carrying amount of accrued interest receivable and payable approximates fair value.

**Other liabilities:** Commitments to extend credit were evaluated and fair value was estimated using the fees currently charged to enter into similar agreements and the present creditworthiness of the counter parties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates.

**Transfers of financial assets**

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

**Comprehensive income**

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities net of tax, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

## Note 2. Investment Securities

Investment securities held-to-maturity consist of the following:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
December 31, 2007				
States & political subdivisions	\$ 2,706,092	\$ 41,747	\$ 5,293	\$ 2,742,546
December 31, 2006				
States & political subdivisions	\$ 3,576,883	\$ 35,705	\$ 32,901	\$ 3,579,687

Investment securities available-for-sale consist of the following:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
December 31, 2007				
U.S. Government and agency securities	\$ 3,194,618	\$ 13,588	\$ 8,076	\$ 3,200,130
Mortgage-backed securities	18,247,464	200,389	165,603	18,282,250
Corporate debt	2,487,965	14,038	43,638	2,458,365
Other securities	2,500	-0-	-0-	2,500
States & political subdivisions	10,317,113	42,892	48,548	10,311,457
Preferred stock	1,000,000	-0-	-0-	1,000,000
	<u>\$35,249,660</u>	<u>\$ 270,907</u>	<u>\$265,865</u>	<u>\$35,254,702</u>
December 31, 2006				
U.S. Government and agency securities	\$ 6,192,821	\$ 3,661	\$ 89,282	\$ 6,107,200
Mortgage-backed securities	19,635,792	80,418	469,885	19,246,325
Corporate debt	5,518,398	201	68,099	5,450,500
Other securities	2,500	-0-	-0-	2,500
States & political subdivisions	10,317,546	12,072	104,970	10,224,648
	<u>\$41,667,057</u>	<u>\$ 96,352</u>	<u>\$732,236</u>	<u>\$41,031,173</u>

Restricted equity securities consisted of the following at December 31:

	2007	2006
Federal Home Loan Bank of Boston Stock	\$ 1,499,100	\$1,522,700
Federal Reserve Bank of Boston Stock	<u>42,000</u>	<u>42,000</u>
	<u>\$ 1,541,100</u>	<u>\$1,564,700</u>

Assets, principally U.S. Agency, Municipal and Mortgage-backed securities, carried at \$27,618,935 and \$26,379,373 and with fair market values of \$27,250,305 and \$26,085,208 at December 31, 2007 and 2006, respectively were pledged to secure public deposits and for other purposes required or permitted by law.

**Note 2. Investment Securities** *(continued)*

The following is a summary of maturities of securities held-to-maturity and available-for-sale as of December 31, 2007:

	<i>Securities held-to-maturity</i>		<i>Securities available-for-sale</i>	
	Amortized Cost	Market Value	Amortized Cost	Market Value
One year or less	\$ 600,803	\$ 598,863	\$ 2,999,956	\$ 2,991,880
After one year through five years	322,010	320,099	2,883,883	2,852,170
After five years through ten years	816,791	828,407	2,929,221	2,960,384
After ten years	770,088	798,777	7,186,636	7,165,518
Mortgage backed securities	196,400	196,400	18,247,464	18,282,250
Other securities	-0-	-0-	1,002,500	1,002,500
	\$2,706,092	\$2,742,546	\$35,249,660	\$35,254,702

There were no securities sold in 2007 or 2006.

Information pertaining to securities with gross unrealized losses at December 31, 2007 and 2006, aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	<i>Less Than 12 Months</i>		<i>12 Months or Greater</i>		<i>Total</i>	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
December 31, 2007						
States & political subdivisions	\$1,918,158	\$29,452	\$ 4,547,842	\$ 24,389	\$ 6,466,000	\$ 53,841
U.S. Government and agency securities	-0-	-0-	2,991,880	8,076	2,991,880	8,076
Mortgage-backed Securities	311,238	2,856	10,057,849	162,747	10,369,087	165,603
Corporate debt	-0-	-0-	1,462,495	43,638	1,462,495	43,638
	\$2,229,396	\$32,308	\$19,060,066	\$238,850	\$21,289,462	\$271,158
December 31, 2006						
States & political subdivisions	\$1,191,605	\$ 3,121	\$ 7,203,949	\$134,750	\$ 8,395,554	\$137,871
U.S. Government and agency securities	-0-	-0-	5,909,400	89,282	5,909,400	89,282
Mortgage-backed securities	-0-	-0-	15,534,948	469,885	15,534,948	469,885
Corporate debt	967,100	7,233	3,983,300	60,866	4,950,400	68,099
	\$2,158,705	\$10,354	\$32,631,597	\$754,783	\$34,790,302	\$765,137

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

At December 31, 2007, the forty debt securities with unrealized losses have depreciated less than 2% from the Company's amortized cost basis. These securities are primarily guaranteed by either the U.S. Government or other government agencies. These unrealized losses relate principally to current interest rates for similar types of securities. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition. As management has the ability to hold debt securities until maturity, or for the foreseeable future if classified as available-for-sale, no declines are deemed to be other-than-temporary.

**Note 3. Loan Servicing**

Mortgage loans serviced for others are not included in the accompanying statements of financial condition. The unpaid principal balances of mortgage loans serviced for others were \$38,410,987 and \$36,673,725 at December 31, 2007 and 2006, respectively.

Mortgage servicing rights totaled \$118,562 and \$130,974 at December 31, 2007 and 2006, respectively. Mortgage servicing rights of \$42,923 and \$31,693 were capitalized in 2007 and 2006, respectively. Amortization of mortgage servicing rights was \$55,335 and \$58,701 in 2007 and 2006, respectively.

**Note 4. Loans**

Loans at December 31, 2007 and 2006 were as follows:

	2007	2006
Commercial	\$ 8,584,575	\$ 7,785,047
Real estate:		
Construction and land development	6,277,127	6,865,407
Residential	100,968,150	97,670,910
Commercial	36,373,977	33,160,248
Total real estate	143,619,254	137,696,565
Installment	2,185,768	2,013,400
Other	2,911,326	1,135,777
	157,300,923	148,630,789
Less: Allowance for loan losses	( 1,501,092)	( 1,502,512)
Deferred loan costs	245,553	232,214
	<b>\$156,045,384</b>	<b>\$147,360,491</b>

The total recorded investment in impaired loans, all of which had allowances determined in accordance with U.S. generally accepted accounting principles, amounted to \$-0- at December 31, 2007 and 2006. The average recorded investment in impaired loans amounted to approximately \$-0- for the years ended December 31, 2007 and 2006, respectively. The allowance for loan losses related to impaired loans amounted to \$-0- at December 31, 2007 and 2006. Interest payments on impaired loans of \$-0 were received in 2007 and 2006.

In addition the Bank had other nonaccrual loans of approximately \$18,956 and \$21,558 at December 31, 2007 and 2006, respectively for which impairment had not been recognized. If interest on these loans had been recognized at the original interest rates, interest income would have increased approximately \$1,081 and \$146 for the years ended December 31, 2007 and 2006, respectively. Loans totaling \$100,573 were delinquent 90 days or more and not in non-accrual status.

The Bank has no commitments to loan additional funds to borrowers with impaired or nonaccrual loans.

**Note 5. Allowance for Loan Losses**

Changes in the allowance for loan losses during the years ended December 31, 2007 and 2006 were as follows:

	2007	2006
Balance at beginning of year	\$ 1,502,512	\$ 1,467,366
Recoveries credited to allowance	1,145	56,560
Provisions charged to operations	-0-	-0-
	1,503,657	1,523,926
Losses charged to allowance	( 2,565)	( 21,414)
Balance at end of year	\$ 1,501,092	\$ 1,502,512

**Note 6. Bank Premises and Equipment**

Bank premises and equipment at December 31, 2007 and 2006 were as follows:

	2007	2006
Land	\$ 100,000	\$ 100,000
Bank building and improvements	6,033,354	5,757,412
Equipment	3,594,778	3,202,542
Construction in progress	614,317	157,784
Land for future expansion	261,582	-0-
	10,604,031	9,217,738
Allowances for depreciation and amortization	( 3,425,993)	( 2,952,343)
	\$ 7,178,038	\$ 6,265,395

Depreciation included in the statements of income amounted to \$473,650 in 2007 and \$450,157 in 2006, of which \$305,060 and \$317,780, respectively, represented equipment depreciation.

The bank leases its Brandon, Bristol and Route 7 South branches, under operating leases, which expire in 2012, 2024 and 2025, respectively. The Route 7 South lease includes two renewal options of ten years each and the Brandon lease contains one five year renewal option. Rental expense on these properties was \$94,097 and \$73,044 for 2007 and 2006, respectively. Minimum annual rentals, excluding common area charges, are as follows:

Years ended December 31,

2008	\$ 92,224
2009	93,749
2010	102,787
2011	104,391
2012	79,377
Thereafter	<u>1,078,914</u>
	<u>\$1,551,442</u>

**Note 7. Investments Carried at Equity**

The Company purchased various partnership interests in limited partnerships. These were partnerships established to acquire, own and rent residential housing for low and moderate income Vermonters located in Vermont, and a limited liability company that offers trust and brokerage services. The investments are accounted for under the equity method of accounting. These equity investments, which are included in other assets, are recorded at cost and adjusted for the Company's proportionate share of the partnership's undistributed earnings or losses. The carrying values of these investments were \$2,145,033 and \$1,547,824 at December 31, 2007 and 2006 respectively. The provision for net undistributed losses of the partnerships charged to earnings was \$122,085 and \$87,644 for 2007 and 2006 respectively.

**Note 8. Deposits**

The maturity distribution of time deposits at December 31, 2007 is as follows:

One year or less	\$35,305,842
After one year through year three	8,478,944
Thereafter	939,204
	<u>\$44,723,990</u>

U.S. Treasury, agency, and Municipal securities with a cost of \$17,101,964 and \$14,863,558 and a market value of \$16,986,714 and \$14,835,582 were pledged to collateralize certain municipal deposits at December 31, 2007 and 2006, respectively.

**Note 9. Repurchase Agreements**

Repurchase agreements at December 31, 2007 and 2006 are as follows:

	2007		2006	
	Amount	Weighted average rate	Amount	Weighted average rate
Securities sold under agreements to repurchase				
Daily rollover	\$9,320,928	*3.22%	\$10,392,998	*3.74%

\* rate is adjusted on a daily basis.

The securities sold under agreements to repurchase are secured by U.S. government and agency bonds and mortgage-backed securities, all of which are under the Bank's control, with a cost of \$10,322,309 and \$11,321,676 and market values of \$10,055,341 and \$11,051,826 at December 31, 2007 and 2006, respectively.

The maximum amount of repurchase agreements outstanding at any month-end during 2007 and 2006 was \$9,572,904 and \$10,392,998, respectively. The daily average amount of repurchase agreements outstanding during 2007 and 2006 was \$7,071,159 and \$8,321,575, respectively.

**Note 10. FHLBB Borrowings**

The Company maintains a \$4,000,000 IDEAL Way Line of Credit with the Federal Home Loan Bank of Boston, which was unused at December 31, 2007 and 2006. Interest on these borrowings is chargeable at a rate determined daily by the Federal Home Loan Bank of Boston and payable monthly.

Collateral on borrowings consists of Federal Home Loan Bank of Boston stock purchased by the Company, all funds placed on deposit with the FHLBB, qualified first mortgages held by the Company of approximately \$85 million at December 31, 2007 and 2006, and any additional holdings that may be pledged as security.

**Note 11. Borrowed Funds**

Borrowed funds at December 31, 2007 and 2006 is as follows:

	2007	2006
Mortgage payable, secured by real estate, prime +1/2 currently 8.25%, due 2011.	\$ 88,971	\$ 108,245
FHLBB short-term borrowings, 5.42% fixed rate, interest payable monthly, principal due at 1/31/07 maturity date.	-0-	1,000,000
FHLBB community development advances, 3.91% to 5.42% fixed rates, interest payable monthly, principal due in 2007.	-0-	5,000,000
FHLBB community development advances, 4.13% to 4.89% fixed rates, interest payable monthly, principal due in 2008.	4,000,000	3,000,000
FHLBB community development advance, 4.31% fixed rate, interest payable monthly, principal due at 3/10/09 maturity date.	1,000,000	1,000,000
FHLBB capped floating advance, one month libor plus .55% currently 5.05%, variable rate, principal due at 3/14/08 maturity date.	2,000,000	2,000,000
FHLBB 10 year/one year option advance, fixed rate 4.39%, principal due 2/21/17, callable 2/20/08 and quarterly thereafter.	3,000,000	-0-
	<b>\$10,088,971</b>	<b>\$12,108,245</b>

Maturity distribution of long-term debt is as follows:

2008	\$ 6,021,116
2009	1,022,926
2010	24,891
2011	20,038
2012	-0-
Thereafter	<u>3,000,000</u>
	<u>\$10,088,971</u>

**Note 12..Income Taxes**

The Company prepares its federal income tax return on a consolidated basis. Federal income taxes are allocated to members of the consolidated group based on taxable income.

Income tax expense included in the statements of income for the years ended December 31, 2007 and 2006 were as follows:

	2007	2006
Currently payable	\$ 266,103	\$ 545,853
Deferred	( 19,639)	( 75,529)
Total income tax expense	<b>\$ 246,464</b>	<b>\$ 470,324</b>

**Note 12. Income Taxes** *(continued)*

The provision for income taxes and the reasons for the difference between tax expense and the amount computed by applying the statutory federal tax rate to income before taxes were as follows:

	2007		2006	
	Amount	Percent	Amount	Percent
Federal statutory rate of pre-tax income	\$ 679,403	34%	\$ 824,778	34%
Tax exempt income	( 198,443)	( 10 )	( 201,806)	( 8 )
Tax credits	( 201,952)	( 10 )	( 119,045)	( 5 )
Cash surrender value	( 63,545)	( 3 )	( 62,990)	( 3 )
Other	31,001	1	29,387	1
Total	\$ 246,464	12%	\$ 470,324	19%

The deferred income tax provision at December 31, 2007 and 2006 consisted of the following items:

	2007	2006
Depreciation/basis adjustment	\$ 20,377	(\$ 8,504)
Bad debts	11,950	( 11,950)
Non-accrual income	( 318)	81
Deferred compensation	( 87,472)	( 76,598)
Deferred loan origination costs	5,869	6,126
Other	33,113	20,249
Start up costs	1,062	4,250
Mortgage servicing rights	( 4,220)	( 9,183)
	<b>(\$19,639)</b>	<b>(\$75,529)</b>

At December 31, 2007 and 2006, gross deferred tax assets and gross deferred tax liabilities were as follows:

	2007	2006
Gross deferred tax assets:		
Allowance for loan losses	\$ 463,265	\$475,215
Non-accrual interest	368	50
Deferred compensation	334,181	246,709
Start up costs	-0-	1,062
Unrealized loss on securities available-for-sale	-0-	216,201
	<b>797,814</b>	<b>939,237</b>
Valuation allowance	-0-	-0-
	<b>797,814</b>	<b>939,237</b>
Gross deferred tax liabilities:		
Depreciation/basis adjustment	245,740	225,363
Mortgage servicing rights	40,311	44,531
Deferred loan origination costs	102,607	96,738
Unrealized gain on securities available-for-sale	1,714	-0-
Other	73,352	40,239
	<b>463,724</b>	<b>406,871</b>
Net deferred tax asset	<b>\$ 334,090</b>	<b>\$532,366</b>

Net deferred income taxes are included in the captions "Other assets" on the balance sheets at December 31, 2007 and 2006, respectively. The deferred tax asset valuation allowance did not change during 2007 and 2006.

### Note 13. Pension Plan

The Bank has a discretionary 401(k) profit sharing plan covering substantially all employees who meet certain age and service requirements. Eligible employees may contribute a percentage of their annual compensation to the plan each year. The Company matches 100% of employee contributions up to 3% of compensation. The Company matched \$89,216 and \$78,041, respectively, of employee contributions under this plan for the years ended December 31, 2007 and 2006, respectively.

The Bank may also make additional discretionary contributions to the plan on behalf of employees who meet the eligibility requirements. These contributions are allocated based on the annual salary of the participants and amounted to \$179,030 and \$152,590 for the years ended December 31, 2007 and 2006, respectively.

### Note 14. Commitments and Contingencies

In the normal course of business, the Company is involved in various legal proceedings. In the opinion of management, after consulting with the Company's legal counsel, any liability resulting from such proceedings would not have a material adverse effect on the Company's financial statements. During 2006, the Bank purchased a building lot in Hinesburg, Vermont with the intent to build a branch. The Bank has entered into a contract to construct the branch in 2008. The anticipated construction cost for the branch and related equipment and furnishings amounts to approximately \$2,000,000.

### Note 15. Financial Instruments with Off-Balance-Sheet Risk

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit, standby and commercial letters of credit, interest rate caps and floors written on adjustable rate loans, and commitments to sell loans. Such instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. The contract or notional amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby and commercial letters of credit is represented by the contractual notional amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments. For interest rate caps and floors written on adjustable rate loans, the contract or notional amounts do not represent exposure to credit loss. The Bank controls the credit risk of its interest rate cap agreements through credit approvals, limits, and monitoring procedures.

The Company sells loans to the Federal Home Loan Bank of Boston (FHLBB) under the FHLBB Mortgage Partnership Finance program (MPF). The Company shares a portion of the credit risk on each mortgage it sells into the MPF program and receives fee income in return. The Company had \$36,120,305 and \$33,885,105 in loans outstanding with MPF at December 31, 2007 and 2006, respectively. The credit risk associated with these loans is deemed to be immaterial.

The Bank generally requires collateral or other security to support financial instruments with credit risk.

	Contract or Notional Amount	
	2007	2006
Financial instruments whose contract amount represent credit risk:		
Commitments to extend credit and available lines of credit	\$30,392,204	\$30,848,279
Standby letters of credit and commercial letters of credit	\$ 738,165	\$ 388,340
MPF credit enhancement obligation	\$ 873,695	\$ 772,684

Commitments to extend credit which are primarily at variable rates, are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by the Bank upon extension of credit is based on management's credit evaluation of the counterparty. Collateral held varies but may include real estate, accounts receivable, inventory, property, plant, and equipment, and income-producing commercial properties.

**Note 15. Financial Instruments with Off-Balance-Sheet Risk** *(Continued)*

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers.

The Bank enters into a variety of interest rate contracts, including interest rate caps and floors written on adjustable rate loans in managing its interest rate exposure. Interest rate caps and floors on loans written by the Bank enables customers to transfer, modify, or reduce their interest rate risk.

**Note 16. Transactions with Related Parties**

In the ordinary course of business, the Bank has loan, deposit and other transactions with its executive officers and directors and organizations with which such persons are associated. In the opinion of management such transactions are on substantially the same terms, including interest rates and collateral as to loans, as those prevailing at the time for comparable transactions with others.

At December 31, 2007 and 2006, loans to the parties mentioned above are as follows:

	2007	2006
Balance, beginning	\$ 2,214,109	\$1,485,382
Additions	112,000	923,407
Repayments	( 194,309)	( 194,680)
Other	( 1,340,381)	-0-
Balance, ending	\$ 791,419	\$2,214,109

Other loan activity consists of activity related to directors who left the board during 2007. Total deposits to related parties approximated \$728,758 and \$1,052,397 on December 31, 2007 and 2006, respectively. Amounts due officers and directors under non-qualified deferred compensation agreements amounts to \$982,885 and \$725,615 at December 31, 2007 and 2006, respectively.

**Note 17. Fair Value of Financial Instruments**

The estimated fair values of the Bank's financial instruments at December 31, 2007 and 2006, are as follows:

	2007		2006	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash and cash equivalent	\$ 5,079,271	\$ 5,079,271	\$ 6,768,157	\$ 6,768,157
Investment securities	39,501,894	39,538,348	46,172,756	46,175,560
Other short-term investments	7,809,469	7,809,469	1,236,524	1,236,524
Mortgage loans held-for-sale	-0-	-0-	130,000	131,878
Loans, net of allowance	156,045,384	156,240,611	147,360,491	145,193,671
Accrued interest receivable	1,056,531	1,056,531	1,100,301	1,100,301
Financial liabilities:				
Deposits	\$181,821,107	\$181,988,104	\$172,188,579	\$172,721,150
Repurchase agreements	9,320,928	9,320,928	10,392,998	10,392,998
Borrowed funds	10,088,971	10,119,398	12,108,245	12,037,652
Accrued interest payable	126,765	126,765	120,392	120,392

The estimated fair values of deferred fees on commitments to extend credit and letters of credit were immaterial at December 31, 2007 and 2006.

The carrying amounts in the preceding table are included in the balance sheets under the applicable captions.

### Note 18. Regulatory Matters

The Company (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum requirements can initiate certain mandatory - and possibly additional discretionary - actions by regulators that, if undertaken, could have a direct material effect on the Companies and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to quantitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2007, that the Company and the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2007, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory frame work for prompt corrective action. To be categorized as well capitalized the Bank must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the institution's category.

The Companies and the Bank's actual capital amounts (000's omitted) and ratios are also presented in the table.

	Actual		Minimums For Capital Adequacy Purposes:		Minimums To Be Well Capitalized Under Prompt Corrective Action Provisions:	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2007:						
Total capital (to risk weighted assets)						
Consolidated	\$ 23,103	14.4%	\$ 12,878	8.0%	N/A	N/A
Bank	\$ 21,319	13.4%	\$ 12,736	8.0%	\$ 15,921	10.0%
Tier 1 capital (to risk weighted assets)						
Consolidated	\$ 21,482	13.3%	\$ 6,439	4.0%	N/A	N/A
Bank	\$ 19,698	12.4%	\$ 6,368	4.0%	\$ 9,552	6.0%
Tier 1 capital (to average assets)						
Consolidated	\$ 21,482	9.6%	\$ 8,907	4.0%	N/A	N/A
Bank	\$ 19,698	8.9%	\$ 8,837	4.0%	\$ 11,046	5.0%
As of December 31, 2006:						
Total capital (to risk weighted assets)						
Consolidated	\$ 22,048	14.9%	\$ 11,834	8.0%	N/A	N/A
Bank	\$ 20,236	13.9%	\$ 11,693	8.0%	\$ 14,612	10.0%
Tier 1 capital (to risk weighted assets)						
Consolidated	\$ 20,426	13.8%	\$ 5,917	4.0%	N/A	N/A
Bank	\$ 18,614	12.7%	\$ 5,846	4.0%	\$ 8,770	6.0%
Tier 1 capital (to average assets)						
Consolidated	\$ 20,426	9.3%	\$ 8,827	4.0%	N/A	N/A
Bank	\$ 18,614	8.5%	\$ 8,757	4.0%	\$ 10,946	5.0%

The Bank is restricted as to the amount of dividends that can be paid. Dividends declared by national banks that exceed the net income (as defined) for the current year plus retained net income for the preceding two years must be approved by the OCC. Regardless of formal regulatory restrictions, the Bank may not pay dividends that would result in its capital levels being reduced below the minimum requirements shown above.

**Note 19. Restrictions on Cash and Due from Banks**

The Company is required to maintain reserve balances in cash with Federal Reserve Banks. The totals of those reserve balances were approximately \$296,000 and \$323,000 at December 31, 2007 and 2006, respectively. In addition, the Company was required to maintain contracted clearing balances of \$100,000 and \$500,000 at December 31, 2007 and 2006, respectively.

**Note 20. Subsequent Events**

On January 1, 2008, the Bank purchased certain assets of the former Lyndon Bank Vergennes, Vermont branch for approximately \$11,700,000 and assumed the deposit liabilities of that branch in the approximate amount of \$9,000,000. The branch opened for business as National Bank of Middlebury, Vergennes office on January 2, 2008.

