

MIDDLEBURY NATIONAL CORPORATION

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

April 7, 2009

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 5, 2009, at 2:00 p.m. for the following purposes:

1. Election of three (3) Directors to serve until the 2012 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 2009
3. To transact any other business that may properly come before the meeting or any adjournment thereof

The close of business March 25, 2009, 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 5, 2009

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 5, 2009, 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 2009 Shareholders' Meeting are Caroline R. Carpenter, John M. McCardell, Jr., Sarah D. Stahl. All will stand for re-election to hold office until the year 2012 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
Class I Directors					
Paul J. Carrara, Jr.	39	Director of Middlebury National Corporation and National Bank of Middlebury; Project Manager, JP Carrara & Sons, Inc., Middlebury, Vermont.	2002	2010	2010
Lawrence W. Miller, II	42	Director of Middlebury National Corporation and National Bank of Middlebury; Financial Consultant; CEO of Danforth Pewterers, Ltd., Middlebury, Vermont	2004	2010	152
G. Kenneth Perine	57	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	1955

Name	Age	Position with Middlebury National Corporation and Principal Occupation	Director Since	Term Expires	Shares Beneficially Owned
Class II Directors					
Linda K. Harmon	59	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	2011	450
Roch F. MacIntyre	64	Director of Middlebury National Corporation and National Bank of Middlebury; Manager, MacIntyre Services, LLC, Middlebury, Vermont.	1980	2011	4614
Class III Directors					
Caroline R. Carpenter	43	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	1394
John M. McCardell, Jr.	59	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	59	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 2008. The aggregate compensation paid during 2008 to seven outside directors was \$97,775. The aggregate compensation paid to the nineteen officers was \$1,404,168. The aggregate cost for contributions to the officers' retirement plan accounts was \$239,972.

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 2009.

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, 2008 and 2007, 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 auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated 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, 2008 and 2007, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

A. M. Peisch & Company, LLP

February 5, 2009
Rutland, Vermont
VT Reg. No 92-0000102

MIDDLEBURY NATIONAL CORPORATION AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
December 31, 2008 and 2007

	2008	2007
ASSETS		
Cash and cash equivalents	\$ 4,235,720	\$ 5,079,271
Interest bearing balances due from Federal Reserve Bank and other financial institutions	7,532,526	140,469
Federal funds sold	-	7,669,000
Securities held-to-maturity (market value of \$2,113,777 in 2008 and \$2,742,546 in 2007)	2,095,758	2,706,092
Securities available-for-sale	38,370,914	35,254,702
Restricted equity securities	1,748,100	1,541,100
Loans, net	181,750,824	156,045,384
Bank premises and equipment, net	9,930,591	7,178,038
Accrued interest receivable	1,115,668	1,056,531
Bank owned life insurance	4,841,403	4,658,082
Other assets	3,788,452	3,286,665
Total assets	\$255,409,956	\$224,615,334
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES		
Deposits:		
Demand	\$ 24,659,656	\$ 23,649,723
NOW	67,948,862	66,055,844
Savings and money market	55,074,239	47,391,550
Time \$100,000 and over	22,343,546	17,165,612
Other time	34,059,177	27,558,378
Total deposits	204,085,480	181,821,107
Borrowed funds	17,178,859	10,088,971
Securities sold under agreements to repurchase	9,935,093	9,320,928
Other liabilities	1,764,788	1,871,223
Total liabilities	232,964,220	203,102,229
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS' EQUITY		
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	21,646,604	20,722,333
Accumulated other comprehensive income (loss)	(11,062)	3,328
Less: Treasury stock at cost (69,198 and 69,848 shares in 2008 and 2007, respectively)	(589,806)	(612,556)
Total shareholders' equity	22,445,736	21,513,105
Total liabilities and shareholders' equity	\$255,409,956	\$224,615,334

See notes to Consolidated Financial Statements.

MIDDLEBURY NATIONAL CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
Years ended December 31, 2008 and 2007

	2008	2007
Interest income		
Interest and fees on loans	\$10,976,769	\$10,823,681
Interest and dividends on securities		
Mortgage-backed securities	1,182,555	923,384
U.S. Government agencies	37,470	183,882
Corporate debt	130,353	192,307
States and political subdivisions	478,311	509,091
Other securities	137,448	103,917
Interest on federal funds sold, Federal Reserve Bank and other interest bearing balances	102,525	199,348
Total interest income	13,045,431	12,935,610
Interest expense		
Interest on time \$100,000 and over	695,590	547,624
Interest on other deposits	2,015,450	2,885,346
Interest on borrowings	822,914	927,776
Total interest expense	3,533,954	4,360,746
Net interest income	9,511,477	8,574,864
Less: provision for loan losses	170,000	-
Net interest income after provision for loan losses	9,341,477	8,574,864
Other operating income		
Service charges on deposit accounts	488,874	395,595
Other service charges, collection and exchange	749,920	631,754
Gain on sale of loans - Net	257,101	200,665
Income from bank owned life insurance	164,802	186,898
Other	107,351	204,705
Total other operating income	1,768,048	1,619,617
Other operating expenses		
Salaries	3,785,050	3,338,871
Pension and other employee benefits	1,251,807	1,207,837
Occupancy expense	780,831	640,031
Equipment expense	579,542	508,274
Other	2,897,062	2,501,225
Total other operating expenses	9,294,292	8,196,238
Income before income taxes	1,815,233	1,998,243
Income tax expense	165,567	246,464
Net income	\$ 1,649,666	\$ 1,751,779
Earnings per share	\$ 1.85	\$ 1.97

See notes to Consolidated Financial Statements.

MIDDLEBURY NATIONAL CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Years ended December 31, 2008 and 2007

	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
Balance, December 31, 2006	\$400,000	\$1,000,000	\$19,638,168	\$(419,684)	\$ (612,556)	\$20,005,928
Comprehensive income						
Net Income	-	-	1,751,779	-	-	1,751,779
Other comprehensive income, net of tax						
Net changes in unrealized loss on securities available- for-sale - Net of tax \$217,915	-	-	-	423,012	-	<u>423,012</u>
Total comprehensive income	-	-	-	-	-	<u>2,174,791</u>
Cash dividends declared (\$.75 per share)	-	-	(667,614)	-	-	(667,614)
Balance, December 31, 2007 as originally presented	\$400,000	\$1,000,000	\$20,722,333	\$ 3,328	\$(612,556)	\$21,513,105
Prior period adjustment, cumulative effect of accounting change to post retirement benefits	-	-	(21,775)	-	-	(21,775)
Balance, December 31, 2007 after restatement	400,000	1,000,000	20,700,558	3,328	(612,556)	21,491,330
Comprehensive income						
Net Income	-	-	1,649,666	-	-	1,649,666
Other comprehensive income, net of tax						
Net changes in unrealized gain (loss) on securities available- for-sale - Net of tax \$7,413	-	-	-	(14,390)	-	<u>(14,390)</u>
Total comprehensive income	-	-	-	-	-	<u>1,635,276</u>
Sale of treasury stock	-	-	-	-	22,750	22,750
Cash dividends declared (\$.79 per share)	-	-	(703,620)	-	-	(703,620)
Balance, December 31, 2008	\$400,000	\$1,000,000	\$21,646,604	\$ (11,062)	\$ (589,806)	\$22,445,736

See notes to Consolidated Financial Statements.

MIDDLEBURY NATIONAL CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31, 2008 and 2007

	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	1,649,666	1,751,779
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	631,379	473,650
Provision for possible loan losses	170,000	-
Provision for deferred taxes	(17,743)	(19,639)
Decrease in accrued income tax	(155,539)	(124,571)
(Increase) Decrease in interest receivable	(59,137)	43,770
Net amortization (accretion)	(22,887)	23,838
(Decrease) increase in interest payable	(3,332)	6,373
Increase in bank owned life insurance	(183,321)	(186,898)
Change in other - Net	176,885	(304,578)
Decrease in mortgage loans held-for-sale	-	130,000
Loss on disposal of assets	1,380	-
Gain on sale of loans	(257,101)	(200,665)
Net cash provided by operating activities	1,930,250	1,593,059
CASH FLOWS FROM INVESTING ACTIVITIES		
Securities held-to-maturity		
Maturities/paydowns	607,900	862,300
Securities available-for-sale		
Sales, maturities, and paydowns	6,854,800	9,337,051
Purchases	(9,967,494)	(2,935,000)
Sales (purchases) of restricted equity securities	(207,000)	23,600
Net change in federal funds and interest bearing balances	276,943	(6,572,945)
Net increase in loans	(25,618,339)	(8,484,228)
Purchase of core deposit intangibles	(692,061)	-
Capital acquisitions	(3,316,106)	(1,386,293)
Net cash used in investing activities	(32,061,357)	(9,155,515)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in demand deposits, NOW accounts and savings accounts	10,585,640	2,954,710
Net increase in certificates of deposit	11,678,733	6,677,818
Increase (Decrease) in securities sold under agreement	614,165	(1,072,070)
Increase (Decrease) in borrowed funds	7,089,888	(2,019,274)
Sale of Treasury Stock	22,750	-
Dividend payments	(703,620)	(667,614)
Net cash provided by financing activities	29,287,556	5,873,570
Net decrease in cash and cash equivalents	(843,551)	(1,688,886)
Cash and cash equivalents		
Beginning	5,079,271	6,768,157
Ending	4,235,720	5,079,271

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MIDDLEBURY NATIONAL CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS *(continued)*
Years ended December 31, 2008 and 2007

	2008	2007
SUPPLEMENTAL SCHEDULE OF CASH FLOW INFORMATION		
Cash payments for:		
Interest	\$3,537,286	\$4,354,373
Income taxes	\$ 336,324	\$ 402,698
SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES		
Unrealized gain / (loss) on securities available-for-sale	\$ (21,803)	\$ 640,927

See 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 collectability of a substantial portion of the Company's loan portfolio is susceptible to changes in local market conditions.

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

Note 1. Significant Accounting Policies *(continued)*

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 Bank is required to invest in their stock. The stock is nonmarketable, and when redeemed, the Bank 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 collectability 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 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

Note 1. Significant Accounting Policies *(continued)*

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.

Intangible Assets

Intangible assets consist of core deposit intangibles resulting from the acquisition of deposit liabilities from Community National Bank. The premium paid to acquire core deposits is being amortized over ten years on a straight-line method. Net intangible assets at December 31, 2008 and 2007 aggregated \$622,855 and \$-0-, respectively, and are included in the caption "Other Assets" on the balance sheets.

Pension Costs

Pension costs relating to the Bank's defined contribution plan are charged to employee benefits expense and are funded as accrued.

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.

Advertising Cost

The Bank expenses advertising costs as incurred.

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 Bank 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.

Note 1. Significant Accounting Policies *(continued)*

Earnings per share

Earnings per share are computed using the weighted average number of shares of common stock outstanding during the year, which was 890,601 and 890,152 shares for 2008 and 2007, respectively.

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.

Investment securities: Fair values for investment securities are based on quoted market prices, where available (level one valuation). If quoted market prices are not available, fair values are calculated based on a formula which uses matrices which interpolate prices according to observable inputs for similar items such as sector, credit spread, rating, maturity, and option premium (level two valuation). The carrying amounts of FHLBB and Federal Reserve Bank of Boston stock approximate 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, 2008				
States & political subdivisions	\$ 2,095,758	\$ 18,019	\$ -	\$ 2,113,777
December 31, 2007				
States & political subdivisions	\$ 2,706,092	\$ 41,747	\$ 5,293	\$ 2,742,546

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
December 31, 2008				
U.S. Government and agency securities	\$195,211	\$ 40,409	\$ -	\$ 235,620
Mortgage-backed securities	24,380,771	585,851	23,578	24,943,044
Corporate debt	2,492,531	-	324,031	2,168,500
Other securities	2,500	-	-	2,500
State & political subdivisions	10,316,661	11,765	307,176	10,021,250
Preferred Stock	1,000,000	-	-	1,000,000
	<u>\$38,387,674</u>	<u>\$638,025</u>	<u>\$654,785</u>	<u>\$38,370,914</u>
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	-	-	2,500
State & political subdivisions	10,317,113	42,892	48,548	10,311,457
Preferred stock	1,000,000	-	-	1,000,000
	<u>\$35,249,660</u>	<u>\$270,907</u>	<u>\$265,865</u>	<u>\$35,254,702</u>

Restricted equity securities consisted of the following at December 31:

	2008	2007
Federal Home Loan Bank of Boston Stock	\$1,706,100	\$1,499,100
Federal Reserve Bank of Boston Stock	42,000	42,000
	<u>\$1,748,100</u>	<u>\$1,541,100</u>

Note 2. Investment Securities *(continued)*

Assets, principally U.S. Government, Municipal and Mortgage-backed securities, with amortized cost of \$29,743,630 and \$27,618,935 and with fair market values of \$30,207,923 and \$27,250,305 at December 31, 2008 and 2007, respectively were pledged to secure public deposits and for other purposes required or permitted by law.

The following is a summary of maturities of securities held-to-maturity and available-for-sale as of December 31, 2008

	<i>Securities held-to-maturity</i>		<i>Securities available-for-sale</i>	
	Amortized Cost	Market Value	Amortized Cost	Market Value
One year or less	\$ 320,213	\$ 320,714	\$ 1,901,390	\$ 1,767,180
After one year through five years	-	-	989,752	805,000
After five years through ten years	1,316,614	1,333,936	4,349,478	4,321,981
After ten years	270,431	270,627	5,763,783	5,531,209
Mortgage backed securities	188,500	188,500	24,380,771	24,943,044
Other Securities	-	-	1,002,500	1,002,500
	\$2,095,758	\$2,113,777	\$38,387,674	\$38,370,914

There were no securities sold in 2008 or 2007.

Information pertaining to securities with gross unrealized losses at December 31, 2008 and 2007, 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, 2008						
State & Political subdivisions	\$4,177,322	\$110,929	\$ 4,504,279	\$196,247	\$ 8,681,601	\$307,176
Mortgage-backed Securities	224,197	3,184	2,499,241	20,394	2,723,438	23,578
Corporate debt	805,000	184,751	1,363,500	139,280	2,168,500	324,031
	\$5,206,519	\$298,864	\$ 8,367,020	\$355,921	\$13,573,539	\$654,785
December 31, 2007						
State & Political subdivisions	\$1,918,158	\$ 29,452	\$ 4,547,842	\$ 24,389	\$6,466,000	\$ 53,841
U.S. Government securities	-	-	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	-	-	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

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 Bank 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, 2008, the thirty one debt securities with unrealized losses have depreciated less than 5% from the Bank's amortized cost basis. 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 \$43,220,493 and \$38,410,987 at December 31, 2008 and 2007, respectively.

Mortgage servicing rights totaled \$134,554 and \$118,562 at December 31, 2008 and 2007, respectively. Mortgage servicing rights of \$72,134 and \$42,923 were capitalized in 2008 and 2007, respectively. Amortization of mortgage servicing rights was \$56,142 and \$55,335 in 2008 and 2007, respectively.

Note 4. Loans

Loans at December 31, 2008 and 2007 were as follows:

	2008	2007
Commercial	\$ 13,702,377	\$ 8,584,575
Real estate:		
Construction and land development	6,417,901	6,277,127
Residential	110,165,435	100,968,150
Commercial	43,929,386	36,373,977
Total real estate	160,512,722	143,619,254
Installment	1,850,901	2,185,768
Other	7,187,410	2,911,326
	183,253,410	157,300,923
Less: Allowance for loan losses	(1,724,215)	(1,501,092)
Deferred loan costs	221,629	245,553
	\$181,750,824	\$156,045,384

The total recorded investment in impaired loans, all of which had allowances determined in accordance with U.S. generally accepted accounting principles, amounted to \$385,363 and \$-0- at December 31, 2008 and 2007. The average recorded investment in impaired loans amounted to approximately \$32,114 and \$-0- for the years ended December 31, 2008 and 2007, respectively. The allowance for loan losses related to impaired loans amounted to \$38,204 and \$-0- at December 31, 2008 and 2007. Interest payments on impaired loans of \$-0- were received in both 2008 and 2007.

In addition the Bank had other nonaccrual loans of approximately \$16,730 and \$18,956 at December 31, 2008 and 2007, 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 \$1,657 and \$1,081 for the years ended December 31, 2008 and 2007, respectively. Loans totaling \$484,979 were delinquent 90 days or more and not in non-accrual status at December 31, 2008.

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, 2008 and 2007 were as follows:

	2008	2007
Balance at beginning of year	\$ 1,501,092	\$ 1,502,512
Recoveries credited to allowance	1,600	1,145
Provisions charged to operations	170,000	-
Branch purchase allocation	92,000	-
	1,764,692	1,503,657
Losses charged to allowance	(40,477)	(2,565)
Balance at end of year	\$ 1,724,215	\$ 1,501,092

Note 6. Bank Premises and Equipment

Bank premises and equipment at December 31, 2008 and 2007 were as follows:

	2008	2007
Land	\$ 454,000	\$ 100,000
Bank Building and improvements	8,458,254	6,033,354
Equipment	3,705,256	3,594,778
Construction in progress	3,331	614,317
Land for future expansion	264,674	261,582
	12,885,515	10,604,031
Allowances for depreciation and amortization	(2,954,924)	(3,425,993)
	\$ 9,930,591	\$ 7,178,038

Depreciation included in the statements of income amounted to \$562,173 in 2008 and \$473,650 in 2007, of which \$354,929 and \$305,060, 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 \$94,963 and \$94,097 for 2008 and 2007, respectively. Minimum annual rentals, excluding common area charges, are as follows:

Years Ended December 31,

2009	\$93,749
2010	102,787
2011	104,391
2012	79,377
2013	77,627
Thereafter	1,001,288
	<u>\$1,459,219</u>

Note 7. Investments Carried at Equity

The Bank 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 Bank's proportionate share of the partnership's undistributed earnings or losses. The carrying values of these investments were \$1,936,350 and \$2,145,033 at December 31, 2008 and 2007 respectively. The provision for net undistributed losses of the partnerships charged to earnings was \$208,683 and \$122,085 for 2008 and 2007 respectively.

Note 8. Intangible Assets

The Bank had the following intangible assets

	December 31,	
	2008	2007
Amortized Intangible Assets		
Core deposit intangibles	\$692,061	\$ -
Less accumulated amortization	69,206	-
	<u>\$622,855</u>	<u>\$ -</u>

Amortization expense for the period ended December 31, 2008 and 2007 was \$69,206 and \$0, respectively.

The aggregate amortization expense for the next five years is:

2009	\$ 69,206
2010	69,206
2011	69,206
2012	69,206
2013	69,206
Thereafter	<u>276,825</u>
	<u>\$622,855</u>

Note 9. Deposits

The maturity distribution of time deposits at December 31, 2008 is as follows:

One year or less	\$45,160,257
After one year through year three	7,297,063
Thereafter	<u>3,945,403</u>
	<u>\$56,402,723</u>

U.S. Treasury, Agency, and Municipal securities with a cost of \$19,383,525 and \$17,101,964 and a market value of \$19,651,153 and \$16,986,714 were pledged to collateralize certain municipal deposits at December 31, 2008 and 2007, respectively.

Note 10. Repurchase Agreements

Repurchase agreements at December 31, 2008 and 2007 are as follows:

	2008		2007	
	Amount	Weighted average rate	Amount	Weighted average rate
Securities sold under agreements to repurchase				
Daily rollover	\$9,935,093	*0.6421%	\$9,320,928	*3.22%

* 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 \$10,164,894 and \$10,322,309 and market values of \$10,321,150 and \$10,055,341 at December 31, 2008 and 2007, respectively.

The maximum amount of repurchase agreements outstanding at any month-end during 2008 and 2007 was \$10,524,972 and \$9,572,904, respectively. The daily average amount of repurchase agreements outstanding during 2008 and 2007 was \$6,902,457 and \$7,071,159, respectively.

Note 11. FHLBB Borrowings

The Bank maintains a \$4,000,000 IDEAL Way Line of Credit with the Federal Home Loan Bank of Boston, which was unused at December 31, 2008 and 2007. 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 Bank, all funds placed on deposit with the FHLBB, qualified first mortgages held by the Bank of approximately \$86 and \$84 million at December 31, 2008 and 2007, respectively, and any additional holdings that may be pledged as security.

Note 12. Borrowed Funds

Borrowed funds at December 31, 2008 and 2007 is as follows:

	2008	2007
Mortgage payable, secured by real estate, prime +1/2 currently 8.25%, due 2011.	\$ 67,854	\$ 88,971
FHLBB capped floating advance, one month libor plus 0.55% currently 5.05%, variable rate, principal due at 3/14/08 maturity date.	-	2,000,000
FHLBB CDA, 4.13% - 4.89% fixed rates, interest payable monthly, principal due in 2008	-	4,000,000
FHLB ST Advance, 3.20% - 3.39% fixed rate, interest paid monthly, principal due in 2009	2,000,000	-
FHLB LT Advance, 2.47% - 4.09% fixed rate, interest paid monthly, principal due 2010 through 2011	6,000,000	-
FHLB CDA Advance, 2.90% - 4.31% fixed rate, interest paid monthly, principal due in 2009 through 2012	6,000,000	1,000,000
FHLB AHP Advance, 0.25% fixed rate, interest paid monthly, principal due at 12/31/28	111,005	-
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	3,000,000
	\$17,178,859	\$10,088,971

Maturity distribution of long-term debt is as follows:

2009	\$ 3,022,971
2010	5,024,878
2011	4,020,005
2012	2,000,000
2013	-
Thereafter	3,111,005
	<u>\$17,178,859</u>

Note 13. 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, 2008 and 2007 were as follows:

	2008	2007
Currently Payable	\$183,310	\$266,103
Deferred	(17,743)	(19,639)
Total income tax expense	\$165,567	\$246,464

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:

	2008		2007	
	Amount	Percent	Amount	Percent
Federal statutory rate of pre-tax income	\$ 617,179	34%	\$ 679,403	34%
Tax exempt income	(206,344)	(11)	(198,443)	(10)
Tax credits	(205,541)	(11)	(201,952)	(10)
Cash surrender value	(62,329)	(3)	(63,545)	(3)
Other	22,602	1	31,001	1
Total	\$ 165,567	10%	\$ 246,464	12%

The deferred income tax provision at December 31, 2008 and 2007 consisted of the following items:

	2008	2007
Depreciation/basis adjustment	\$ 202,027	\$ 20,377
Bad debts	(10,582)	11,950
Non-accrual income	(6,070)	(318)
Deferred compensation	(26,591)	(87,472)
Deferred loan origination costs	8,991	5,869
Off balance sheet accrual	(41,140)	-
Tax credit carryover	(108,637)	-
Deposit intangible	(7,889)	-
Other	(33,289)	33,113
Start up costs	-	1,062
Mortgage servicing rights	5,437	(4,220)
	\$ (17,743)	\$ (19,639)

Note 13. Income Taxes (continued)

At December 31, 2008 and 2007, gross deferred tax assets and gross deferred tax liabilities were as follows:

	2008	2007
Gross deferred tax assets:		
Allowance for loan losses	\$ 473,847	\$463,265
Off balance sheet accrual	41,140	-
Non-accrual interest	6,438	368
Deferred compensation	360,772	334,181
Tax credit carryover	108,637	-
Deposit Intangible	7,889	-
Unrealized loss on securities available-for-sale	5,699	-
	<u>1,004,422</u>	<u>797,814</u>
Valuation allowance	-	-
	<u>1,004,422</u>	<u>797,814</u>
Gross deferred tax liabilities:		
Depreciation/basis adjustment	447,767	245,740
Mortgage servicing rights	45,748	40,311
Deferred loan origination costs	111,598	102,607
Unrealized gain on securities available-for-sale	-	1,714
Other	40,063	73,352
	<u>645,176</u>	<u>463,724</u>
Net deferred tax asset	<u>\$ 359,246</u>	<u>\$334,090</u>

Net deferred income taxes are included in the captions "Other assets" on the balance sheets at December 31, 2008 and 2007, respectively. The deferred tax asset valuation allowance did not change during 2008 and 2007.

As of December 31, 2008, the Company has general business tax credits of \$108,637 available for carryover through December 31, 2027.

Note 14. 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 Bank matches 100% of employee contributions up to 3% of compensation. The Bank matched \$98,659 and \$89,216, respectively, of employee contributions under this plan for the years ended December 31, 2008 and 2007, 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 \$172,398 and \$179,030 for the years ended December 31, 2008 and 2007, respectively.

Note 15. 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.

Note 16. 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

Note 16. Financial Instruments with Off-Balance-Sheet Risk *(continued)*

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 Bank sells loans to the Federal Home Loan Bank of Boston (FHLBB) under the FHLBB Mortgage Partnership Finance program (MPF). The Bank shares a portion of the credit risk on each mortgage it sells into the MPF program and receives fee income in return. The Bank had \$41,152,603 and \$36,120,305 in loans outstanding with MPF at December 31, 2008 and 2007, 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	
	2008	2007
Financial instruments whose contract amount represent credit risk:		
<u>Commitments to extend credit and available lines of credit</u>	<u>\$33,029,880</u>	<u>\$30,392,204</u>
<u>Standby letters of credit and commercial letters of credit</u>	<u>\$ 237,000</u>	<u>\$ 738,165</u>
<u>MPF credit enhancement obligation</u>	<u>\$ 1,073,142</u>	<u>\$ 873,695</u>

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 counter-party. Collateral held varies but may include real estate, accounts receivable, inventory, property, plant, and equipment, and income-producing commercial properties.

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 enable customers to transfer, modify, or reduce their interest rate risk.

Note 17. 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, 2008 and 2007, loans to the parties mentioned above are as follows:

	2008	2007
Balance, beginning	\$791,419	\$2,214,109
Additions	-	112,000
Repayments	(470,211)	(194,309)
Other	-	(1,340,381)
<u>Balance, ending</u>	<u>\$321,208</u>	<u>\$ 791,419</u>

Other loan activity consists of activity related to directors who left the board during 2007. Total deposits to related parties approximated \$808,342 and \$728,758 on December 31, 2008 and 2007, respectively. Amounts due officers and directors under non-qualified deferred compensation agreements amounts to \$1,090,287 and \$982,885 at December 31, 2008 and 2007, respectively.

Note 18. Fair Value of Financial Instruments

The estimated fair values of the Bank's financial instruments at December 31, 2008 and 2007, are as follows:

	2008		2007	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial Assets:				
Cash and cash equivalents	\$ 4,285,720	\$ 4,285,720	\$ 5,079,271	\$ 5,079,271
Investment securities	40,466,672	40,484,691	37,960,794	37,997,248
Other short-term investments	7,532,526	7,532,526	7,809,469	7,809,469
Restricted equity securities	1,748,100	1,748,100	1,541,100	1,541,100
Loans, net of allowance	181,750,824	188,491,037	156,045,384	156,240,611
Accrued interest receivable	1,115,668	1,115,668	1,056,531	1,056,531
Financial liabilities:				
Deposits	\$204,085,480	\$204,824,461	\$181,821,107	\$181,988,104
Repurchase agreements	9,935,093	9,935,093	9,320,928	9,320,928
Borrowed funds	17,178,859	7,542,865	10,088,971	10,119,398
Accrued interest payable	123,428	123,428	126,765	126,765

The fair market value for investments were calculated utilizing level two valuation as noted in Note 1.

The estimated fair values of deferred fees on commitments to extend credit and letters of credit were immaterial at December 31, 2008 and 2007.

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

Note 19. Regulatory Matters

The Corporation (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 Corporation's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Corporation 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 Corporation 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, 2008, that the Corporation and the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2008, 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.

Note 19. Regulatory Matters *(continued)*

The Corporation's 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, 2008						
Total capital (to risk weighted assets)						
Consolidated	\$23,648	12.3%	\$15,343	8.0%	N/A	N/A
Bank	\$21,838	11.5%	\$15,187	8.0%	\$18,984	10.0%
Tier 1 capital (to risk weighted assets)						
Consolidated	\$21,803	11.4%	\$7,672	4.0%	N/A	N/A
Bank	\$19,993	10.5%	\$7,593	4.0%	\$11,390	6.0%
Tier 1 capital (to average assets)						
Consolidated	\$21,803	8.6%	\$10,130	4.0%	N/A	N/A
Bank	\$19,993	8.0%	\$10,054	4.0%	\$12,568	5.0%
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%	\$12,739	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%

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 20. Restrictions on Cash and Due from Banks

The Bank is required to maintain reserve balances in cash with the Federal Reserve Bank of Boston. The totals of those reserve balances were approximately \$247,000 and \$296,000 at December 31, 2008 and 2007, respectively. In addition, the Bank contracted to maintain clearing balances of \$100,000 at December 31, 2008 and 2007.

The nature of the Bank's business requires that it maintain amounts due from banks, which at times, may exceed federally insured limits. No losses have been experienced in these accounts.

Note 21. Branch Acquisition

On January 1, 2008 the Bank purchased assets and assumed the deposit liabilities of the former LyndonBank Vergennes, VT branch. Assets totaling \$12,031,390 were purchased with \$8,736,762 in deposit related liabilities assumed and \$3,294,628 paid out. The following is a schedule of the assets acquired:

Loans - net of \$92,000 allowance	\$10,401,377
Building and equipment	760,599
Core deposit intangible	692,061
Other assets (primarily teller cash)	177,353
	<u>\$12,031,390</u>

Note 22. Prior Period Adjustment

The Financial Accounting Standards Board (FASB) issued a pronouncement regarding the accounting for the split dollar life insurance endorsements on deferred compensation and post retirement benefits effective December 31, 2007. The new rule requires that employers recognize the liability for these split dollar arrangements. The cumulative effect of this pronouncement is presented in the statement of changes in shareholder equity. The effect on current year income was to increase other expense \$7,416.

Note 23. Subsequent Events

On January 28, 2009, the Company received preliminary approval from the U.S. Treasury to participate in the Capital Purchase Program (CPP). The Company has been tentatively approved to issue \$5.618 million of preferred stock to the United States Department of the Treasury subject to shareholder approval.