

# MIDDLEBURY NATIONAL CORPORATION

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

April 6, 2010

## 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 4, 2009, at 2:00 p.m. for the following purposes:

1. Election of three (3) Directors to serve until the 2013 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 2010
3. To transact any other business that may properly come before the meeting or any adjournment thereof

The close of business March 24, 2010, 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 4, 2010

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 4, 2010, 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 2010 Shareholders' Meeting are Paul J. Carrara, Jr., Lawrence W. Miller, II, and G. Kenneth Perine. All will stand for re-election to hold office until the year 2013 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.	40	Director of Middlebury National Corporation and National Bank of Middlebury; General Manager, JP Carrara & Sons, Inc., Middlebury, VT	2002	2010	2710
Lawrence W. Miller, II	43	Director of Middlebury National Corporation and National Bank of Middlebury; Chief Executive Officer, Danforth Pewterers, Ltd., Middlebury, VT	2004	2010	152
G. Kenneth Perine	58	Director of Middlebury National Corporation and National Bank of Middlebury; Executive Vice President, Middlebury National Corporation; President, National Bank of Middlebury, Middlebury, VT	1990	2010	2792
<b>Class II Directors</b>					
Michael G. McLaughlin	38	Director of Middlebury National Corporation and National Bank of Middlebury; Vice President Business Development and Marketing, Bread Loaf Corporation, Middlebury, VT	2009	2011	76

Name	Age	Position with Middlebury National Corporation and Principal Occupation	Director Since	Term Expires	Shares Beneficially Owned
<b>Class II Directors</b> <i>(continued)</i>					
Linda K. Harmon	60	Director of Middlebury National Corporation and National Bank of Middlebury; President, H&M Mountain Enterprises, Inc., dba Mary's at Baldwin Creek, Bristol, VT	1995	2011	450
Roch F. MacIntyre	65	Director of Middlebury National Corporation and National Bank of Middlebury; Manager, MacIntyre Services, LLC, Middlebury, VT; Manager, Trackage Terminals, LLC, Middlebury, VT	1980	2011	4614
<b>Class III Directors</b>					
Caroline R. Carpenter	44	Director of Middlebury National Corporation and National Bank of Middlebury; Executive Vice President and Technology Manager, National Bank of Middlebury, Middlebury, VT	2005	2012	1544
John M. McCardell, Jr.	60	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	2012	2,000
Sarah D. Stahl	60	Director of Middlebury National Corporation and National Bank of Middlebury; President, Middlebury National Corporation; Operations Manager, Vermont Folklife Center, Middlebury, VT	1988	2012	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 2009. The aggregate compensation paid during 2009 to seven outside directors was \$88,800. The aggregate compensation paid to the nineteen officers' was \$1,393,154. The aggregate cost for contributions to the officers' retirement plan accounts was \$251,490.

#### 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 2010.

#### 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, 2009 and 2008, 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, 2009 and 2008, 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. Pevich & Company, LLP*

February 3, 2010  
Rutland, Vermont  
VT Reg. No 92-0000102

**MIDDLEBURY NATIONAL CORPORATION AND SUBSIDIARY**  
**CONSOLIDATED BALANCE SHEETS**  
**December 31, 2009 and 2008**

	2009	2008
<b>ASSETS</b>		
Cash and cash equivalents	\$ 3,889,515	\$ 4,235,720
Interest bearing balances due from Federal Reserve Bank and other financial institutions	13,921,344	7,532,526
Securities held-to-maturity (market value of \$1,132,642 in 2009 and \$2,113,777 in 2008)	1,085,767	2,095,758
Securities available-for-sale	49,240,727	38,370,914
Restricted equity securities	1,748,100	1,748,100
Loans, net	186,121,774	181,750,824
Bank premises and equipment, net	9,826,403	9,930,591
Accrued interest receivable	1,039,926	1,115,668
Bank owned life insurance	5,032,866	4,841,403
Other assets	5,308,803	3,788,452
Total assets	\$277,215,225	\$255,409,956
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>LIABILITIES</b>		
Deposits:		
Demand	\$ 27,161,930	\$ 24,659,656
NOW	74,919,665	67,948,862
Savings and money market	60,534,790	55,074,239
Time \$100,000 and over	25,456,807	22,343,546
Other time	38,005,692	34,059,177
Total deposits	226,078,884	204,085,480
Borrowed funds	14,152,014	17,178,859
Securities sold under agreements to repurchase	10,485,486	9,935,093
Other liabilities	2,562,734	1,764,788
Total liabilities	253,279,118	232,964,220
<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	22,498,526	21,646,604
Accumulated other comprehensive income (loss)	627,387	(11,062)
	24,525,913	23,035,542
Less: Treasury stock at cost (69,198 shares in 2009 and 2008, respectively)	(589,806)	(589,806)
Total shareholders' equity	23,936,107	22,445,736
Total liabilities and shareholders' equity	\$277,215,225	\$255,409,956

See notes to Consolidated Financial Statements.

**MIDDLEBURY NATIONAL CORPORATION AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF INCOME**  
**Years ended December 31, 2009 and 2008**

	2009	2008
Interest income		
Interest and fees on loans	\$10,516,582	\$10,976,769
Interest and dividends on securities		
Mortgage-backed securities	1,119,567	1,182,555
U.S. Government agencies	89,138	37,470
Corporate debt	121,070	130,353
States and political subdivisions	450,752	478,311
Other securities	77,520	137,448
Interest on federal funds sold, Federal Reserve Bank and other interest bearing balances	19,264	102,525
<b>Total interest income</b>	<b>12,393,893</b>	<b>13,045,431</b>
Interest expense		
Interest on time \$100,000 and over	682,740	695,590
Interest on other deposits	1,370,912	2,015,450
Interest on borrowings	637,532	822,914
<b>Total interest expense</b>	<b>2,691,184</b>	<b>3,533,954</b>
<b>Net interest income</b>	<b>9,702,709</b>	<b>9,511,477</b>
Less: provision for loan losses	653,000	170,000
<b>Net interest income after provision for loan loss</b>	<b>9,049,709</b>	<b>9,341,477</b>
Other operating income		
Service charges on deposit accounts	463,006	488,874
Other service charges, collection and exchange	787,509	749,920
Gain on sale of loans- Net	720,218	257,101
Gain on sale of securities - net	193,165	-
Income from bank owned life insurance	169,786	164,802
Other	120,766	107,351
<b>Total other operating income</b>	<b>2,454,450</b>	<b>1,768,048</b>
Other operating expenses		
Salaries	3,967,546	3,785,050
Pension and other employee benefits	1,352,900	1,251,807
Occupancy expense	820,937	780,831
Equipment expense	600,744	579,542
FDIC insurance expense	454,445	98,521
Other	2,662,023	2,798,541
<b>Total other operating expenses</b>	<b>9,858,595</b>	<b>9,294,292</b>
<b>Income before income taxes</b>	<b>1,645,564</b>	<b>1,815,233</b>
Income tax expense	81,000	165,567
<b>Net income</b>	<b>\$ 1,564,564</b>	<b>\$ 1,649,666</b>
<b>Earnings per share</b>	<b>\$1.76</b>	<b>\$1.85</b>

See notes to Consolidated Financial Statements.

**MIDDLEBURY NATIONAL CORPORATION AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**  
**Years ended December 31, 2009 and 2008**

	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
<b>Balance, December 31, 2007</b>	\$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 loss on securities available- for-sale - Net of tax \$7,413	-	-	-	(14,390)	-	(14,390)
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)
<b>Balance, December 31, 2008</b>	\$400,000	\$1,000,000	\$21,646,604	\$(11,062)	\$(589,806)	\$22,445,736
Comprehensive income						
Net income	-	-	1,564,564	-	-	1,564,564
Other comprehensive income, net of tax						
Net changes in unrealized gain (loss) on securities available- for-sale - Net of tax \$328,897	-	-	-	638,449	-	638,449
Total comprehensive income	-	-	-	-	-	<u>2,203,013</u>
Cash dividends declared (\$ .80 per share)	-	-	(712,642)	-	-	(712,642)
<b>Balance, December 31, 2009</b>	\$400,000	\$1,000,000	\$22,498,526	\$627,387	\$(589,806)	\$23,936,107

See notes to Consolidated Financial Statements.

**MIDDLEBURY NATIONAL CORPORATION AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**Years ended December 31, 2009 and 2008**

	2009	2008
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$1,564,564	\$1,649,666
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	687,799	631,379
Provision for possible loan losses	653,000	170,000
Provision for deferred taxes	(399,429)	(17,743)
Increase (Decrease) in accrued income tax	353,187	(155,539)
(Increase) decrease in interest receivable	75,742	(59,137)
Net amortization (accretion)	(32,911)	(22,887)
Decrease in interest payable	(33,465)	(3,332)
Increase in bank owned life insurance	(191,463)	(183,321)
Change in other - Net	(1,040,801)	176,885
Loss on disposal of assets	-	1,380
Securities (gains) losses	(193,165)	-
Gain on sale of loans	(720,218)	(257,101)
Net cash provided by operating activities	722,840	1,930,250
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Securities held-to-maturity		
Maturities / paydowns	999,800	607,900
Securities available-for-sale		
Sales, maturities, and paydowns	14,494,076	6,854,800
Purchases	(24,160,276)	(9,967,494)
Purchases in restricted equity securities	-	(207,000)
Net change in federal funds and interest bearing balances	(6,388,818)	276,943
Net increase in loans	(4,303,732)	(25,618,339)
Purchase of core deposit intangibles	-	(692,061)
Capital acquisitions	(514,405)	(3,316,106)
Net cash used by investing activities	(19,873,355)	(32,061,357)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net increase in demand deposits,		
NOW accounts and savings accounts	14,933,628	10,585,640
Net increase in certificates of deposit	7,059,776	11,678,733
Increase in securities sold under agreement	550,393	614,165
Increase (decrease) in borrowed funds	(3,026,845)	7,089,888
Sale of Treasury Stock	-	22,750
Dividend payments	(712,642)	(703,620)
Net cash provided by financing activities	18,804,310	29,287,556
Net decrease in cash and cash equivalents	(346,205)	(843,551)
Cash and cash equivalents		
Beginning	4,235,720	5,079,271
Ending	\$3,889,515	\$4,235,720

(continued)

**MIDDLEBURY NATIONAL CORPORATION AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)**  
**Years ended December 31, 2009 and 2008**

	2009	2008
<b>SUPPLEMENTAL SCHEDULE OF CASH FLOW INFORMATION</b>		
Cash payments for:		
Interest	\$2,724,764	\$3,537,286
Income taxes	\$ 146,721	\$ 336,324

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

Unrealized gain (loss) on securities available-for-sale	\$ 967,347	\$ (21,803)
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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 six branches in west 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.

**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 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

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

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 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. The premium paid to acquire core deposits is being amortized over ten years on a straight-line method. Net intangible assets at December 31, 2009 and 2008 aggregated \$553,649 and \$622,855, 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.

The Bank adopted provisions of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes- an interpretation of FASB Statement No. 109" ("FIN No.48"). FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return, and provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. Management reviews the inventory of tax positions taken at each reporting period to assess the more-likely-than-not recognition threshold proposed by FIN 48. Previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold are derecognized in the first subsequent financial reporting period in which that threshold is no longer met.

**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

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

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.

**Earnings per share**

Earnings per share are computed using the weighted average number of shares of common stock outstanding during the year, which was 890,802 and 890,601 shares for 2009 and 2008, 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.

## Note 1. Significant Accounting Policies (continued)

### 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.

### Accounting Pronouncement

During June 2009, the Financial Accounting Standards Board (FASB) issued Statements of Financial Accounting Standards No. 166, accounting for transfers of financial assets, and No. 167, amendments to FASB interpretation No. 46R. These statements, which are effective for years beginning after November 15, 2009, will require additional information about transfers of financial assets, clarify when sales treatment is warranted and revise treatment of Variable Interest Entities for consolidation purposes. The effect of these pronouncements is not expected to have a material effect on the Company's financial statements.

### Note 2. Investment Securities

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2009				
States & political subdivisions	\$ 1,085,767	\$ 46,875	\$ -	\$ 1,132,642
December 31, 2008				
States & political subdivisions	\$ 2,095,758	\$ 18,019	\$ -	\$ 2,113,777

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2009				
U.S. Government and agency securities	\$18,175,007	\$ 40,489	\$ 49,030	\$18,166,466
Mortgage-backed securities	19,200,325	745,305	2,435	19,943,195
State & political subdivisions	9,914,808	216,258	-	10,131,066
Preferred Stock	1,000,000	-	-	1,000,000
	<u>\$48,290,140</u>	<u>\$1,002,052</u>	<u>\$ 51,465</u>	<u>\$49,240,727</u>
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>

Restricted equity securities consisted of the following at December 31:

	2009	2008
Federal Home Loan Bank of Boston Stock	\$ 1,706,100	\$1,706,100
Federal Reserve Bank of Boston Stock	42,000	42,000
	<u>\$ 1,748,100</u>	<u>\$1,748,100</u>

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

Assets, principally U.S. Government, Municipal and Mortgage-backed securities, with amortized cost of \$32,443,352 and \$29,743,630 and with fair values of \$33,300,835 and \$30,207,923 at December 31, 2009 and 2008, 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, 2009:

	Securities held-to-maturity		Securities available-for-sale	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
One year or less	\$ -	\$ -	\$ -	\$ -
After one year through five years	-	-	18,353,866	18,337,369
After five years through ten years	1,085,767	1,132,642	7,173,102	7,361,947
After ten years	-	-	2,562,847	2,598,216
Mortgage backed securities	-	-	19,200,325	19,943,195
Other Securities	-	-	1,000,000	1,000,000
	\$1,085,767	\$1,132,642	\$48,290,140	\$49,240,727

Proceeds from the sale of available-for-sale securities amounted to \$3,040,677 and \$-0- in 2009 and 2008, respectively. Gross realized gains were \$193,165 and \$-0- in 2009 and 2008, respectively.

Information pertaining to securities with gross unrealized losses at December 31, 2009 and 2008, aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
December 31, 2009						
U.S. Government Securities	\$13,928,630	\$ 49,030	\$ -	\$ -	\$13,928,630	\$ 49,030
Mortgage-backed Securities	1,947,836	2,435	-	-	1,947,836	2,435
	\$15,876,466	\$ 51,465	\$ -	\$ -	\$15,876,466	\$ 51,465
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

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, 2009, the ten debt securities with unrealized losses have depreciated less than 1% 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 \$59,652,533 and \$43,220,493 at December 31, 2009 and 2008, respectively.

Mortgage servicing rights totaled \$263,812 and \$134,554 at December 31, 2009 and 2008, respectively. Mortgage servicing rights of \$206,032 and \$72,134 were capitalized in 2009 and 2008, respectively. Amortization of mortgage servicing rights was \$76,775 and \$56,142 in 2009 and 2008, respectively.

**Note 4. Loans**

Loans at December 31, 2009 and 2008 were as follows:

	2009	2008
Commercial	\$ 14,582,488	\$ 13,702,377
Real estate:		
Construction and land development	5,974,641	6,417,901
Residential	111,898,437	110,165,435
Commercial	47,005,207	43,929,386
Total real estate	164,878,285	160,512,722
Installment	1,778,442	1,850,901
Other	6,920,656	7,187,410
	188,159,871	183,253,410
Less: Allowance for loan losses	(2,264,210)	(1,724,215)
Deferred loan costs	226,113	221,629
	<b>\$186,121,774</b>	<b>\$181,750,824</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 \$455,118 and \$385,363 at December 31, 2009 and 2008. The average recorded investment in impaired loans amounted to approximately \$411,414 and \$32,114 for the years ended December 31, 2009 and 2008, respectively. The allowance for loan losses related to impaired loans amounted to \$113,357 and \$38,204 at December 31, 2009 and 2008. Interest payments on impaired loans of \$-0- were received in both 2009 and 2008.

In addition the Bank had other nonaccrual loans of approximately \$928,684 and \$16,730 at December 31, 2009 and 2008, 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 \$36,529 and \$1,657 for the years ended December 31, 2009 and 2008, respectively. Loans totaling \$541,855 and \$484,979 were delinquent 90 days or more and not in non-accrual status at December 31, 2009 and 2008, respectively.

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, 2009 and 2008 were as follows:

	2009	2008
Balance at beginning of year	\$1,724,215	\$1,501,092
Recoveries credited to allowance	4,352	1,600
Provisions charged to operations	653,000	170,000
Branch purchase allocation	-	92,000
	2,381,567	1,764,692
Losses charged to allowance	(117,357)	(40,477)
Balance at end of year	\$2,264,210	\$1,724,215

**Note 6. Bank Premises and Equipment**

Bank premises and equipment at December 31, 2009 and 2008 were as follows:

	2009	2008
Land	\$ 454,000	\$ 454,000
Bank Building and improvements	8,602,913	8,458,254
Equipment	3,895,504	3,705,256
Construction in progress	182,829	3,331
Land for future expansion	264,674	264,674
	13,399,920	12,885,515
Allowances for depreciation and amortization	(3,573,517)	(2,954,924)
	\$9,826,403	\$9,930,591

Depreciation included in the statements of income amounted to \$618,593 in 2009 and \$562,173 in 2008, of which \$384,232 and \$354,929, 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 \$98,366 and \$94,963 for 2009 and 2008, respectively. Minimum annual rentals, excluding common area charges, are as follows:

Years Ended December 31,

2010	\$ 102,787
2011	104,391
2012	79,377
2013	77,627
2014	78,224
Thereafter	923,064
	<u>\$1,365,470</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 \$1,740,449 and \$1,936,350 at December 31, 2009 and 2008 respectively. The provision for net undistributed losses of the partnerships charged to earnings was \$195,901 and \$208,683 for 2009 and 2008 respectively.

**Note 8. Intangible Assets**

The Bank had the following intangible assets

	December 31,	
	2009	2008
Amortized Intangible Assets		
Core deposit intangibles	<b>\$692,061</b>	\$692,061
Less accumulated amortization	<b>138,412</b>	69,206
	<b>\$553,649</b>	<b>\$622,855</b>

Amortization expense for the period ended December 31, 2009 and 2008 was \$69,206, respectively.

The aggregate amortization expense for the next five years is:

2010	\$ 69,206
2011	69,206
2012	69,206
2013	69,206
2014	69,206
Thereafter	<u>207,619</u>
	<u>\$553,649</u>

**Note 9. Deposits**

The maturity distribution of time deposits at December 31, 2009 is as follows:

One year or less	\$46,896,337
After one year through year three	11,368,137
Thereafter	<u>5,198,025</u>
	<u>\$63,462,499</u>

U.S. Treasury, Agency, and Municipal securities with a cost of \$21,359,462 and \$19,383,525 and a market value of \$21,851,018 and \$19,651,153 were pledged to collateralize certain municipal deposits at December 31, 2009 and 2008, respectively.

**Note 10. Repurchase Agreements**

Repurchase agreements at December 31, 2009 and 2008 are as follows:

	2009		2008	
	Amount	Weighted average rate	Amount	Weighted average rate
Securities sold under agreements to repurchase				
Daily rollover	<b>\$10,485,486</b>	<b>0.3428%</b>	\$9,935,093	0.6421%

\* 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 \$10,888,103 and \$10,164,894 and market values of \$11,233,189 and \$10,321,150 at December 31, 2009 and 2008, respectively.

**Note 10. Repurchase Agreements (continued)**

The maximum amount of repurchase agreements outstanding at any month-end during 2009 and 2008 was \$10,485,486 and \$10,524,972, respectively. The daily average amount of repurchase agreements outstanding during 2009 and 2008 was \$7,665,311 and \$6,902,457, 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, 2009 and 2008. 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 million at December 31, 2009 and 2008, respectively, and any additional holdings that may be pledged as security.

**Note 12. Borrowed Funds**

Borrowed funds at December 31, 2009 and 2008 is as follows:

	2009	2008
Mortgage payable, secured by real estate, prime +1/2 currently 8.25%, due 2011.	\$ 44,582	\$ 67,854
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	6,000,000
FHLB CDA Advance, 2.90% - 3.19% fixed rate, interest paid monthly, principal due in 2009 through 2012	5,000,000	6,000,000
FHLB AHP Advance, 0.25% fixed rate, principal and interest paid monthly, principal due 12/31/28	107,432	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
	<b>\$14,152,014</b>	<b>\$17,178,859</b>

Maturity distribution of long-term debt is as follows:

2009	\$5,030,105
2010	4,025,546
2011	2,005,555
2012	5,570
2013	5,584
Thereafter	3,079,654
	<u>\$14,152,014</u>

The Bank also had an unsecured \$1,500,000 federal funds line of credit with Banker's Bank Northeast which was unused at December 31, 2009 and 2008.

**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, 2009 and 2008 were as follows:

	2009	2008
Currently Payable	\$480,429	\$183,310
Deferred	(399,429)	(17,743)
<b>Total income tax expense</b>	<b>\$ 81,000</b>	<b>\$165,567</b>

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:

	2009		2008	
	Amount	Percent	Amount	Percent
Federal statutory rate of pre-tax income	\$559,491	34%	\$617,179	34%
Tax exempt income	(212,292)	( 13 )	(206,344)	( 11 )
Tax credits	(192,207)	( 12 )	(205,541)	( 11 )
Cash surrender value	(65,097)	( 4 )	(62,329)	( 3 )
Other	(8,895)	1	22,602	1
<b>Total</b>	<b>\$ 81,000</b>	<b>6%</b>	<b>\$165,567</b>	<b>10%</b>

The deferred income tax provision at December 31, 2009 and 2008 consisted of the following items:

	2009	2008
Depreciation/basis adjustment	\$ (51,981)	\$202,027
Bad debts	(195,066)	(10,582)
Non-accrual income	(19,791)	(6,070)
Deferred compensation	(33,202)	(26,591)
Deferred loan origination costs	(401)	8,991
Off balance sheet accrual	(8,160)	(41,140)
Tax credit carryover	(118,554)	(108,637)
Deposit intangible	(7,888)	(7,889)
Other	(8,334)	(33,289)
Mortgage servicing rights	43,948	5,437
	<b>\$(399,429)</b>	<b>\$(17,743)</b>

**Note 13. Income Taxes** (continued)

At December 31, 2009 and 2008, gross deferred tax assets and gross deferred tax liabilities were as follows:

	2009	2008
Gross deferred tax assets:		
Allowance for loan losses	\$ 668,913	\$ 473,847
Off balance sheet accrual	49,300	41,140
Non-accrual interest	26,229	6,438
Deferred compensation	393,974	360,772
Tax credit carryover	227,191	108,637
Deposit Intangible	15,777	7,889
Unrealized loss on securities available-for-sale	-	5,699
	1,381,384	1,004,422
Valuation allowance	-	-
	1,381,384	1,004,422
Gross deferred tax liabilities:		
Depreciation/basis adjustment	395,786	447,767
Mortgage servicing rights	89,696	45,748
Deferred loan origination costs	111,198	111,598
Unrealized gain on securities available-for-sale	323,200	-
Other	31,729	40,063
	951,609	645,176
Net deferred tax asset	\$ 429,775	\$ 359,246

Net deferred income taxes are included in the captions "Other assets" on the balance sheets at December 31, 2009 and 2008, respectively. The deferred tax asset valuation allowance did not change during 2009 and 2008.

As of December 31, 2009, the Company has general business tax credits of \$227,191 available for carryover through December 31, 2028.

Deferred tax assets are recognized subject to management's judgment that realization is more likely than not as GAAP allows for the recognition and measurement of deductible temporary differences to the extent that it is more likely than not that the deferred tax asset will be realized. Based on the temporary taxable items, historical taxable income and estimates of future taxable income, the Bank believes that it is more likely than not that the deferred tax assets at December 31, 2009 will be realized.

Based on management's evaluation, management has concluded that there were no significant uncertain tax positions requiring recognition in the Bank's financial statements at December 31, 2009. Although the Bank is not currently the subject of tax examination by the Internal Revenue Service (IRS), the Bank's tax years ended December 31, 2006 through 2009 are open to examination by the IRS under the applicable statute of limitations.

The Bank may from time-to-time be assessed interest and/or penalties by federal or state tax jurisdictions, although any such assessments historically have been minimal and immaterial to the Bank's financial results. In the event that the Bank receives an assessment for interest and/or penalties, it will be classified in the financial statements as Other expenses.

**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 \$110,092 and \$98,659, respectively, of employee contributions under this plan for the years ended December 31, 2009 and 2008, 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 \$199,556 and \$172,398 for the years ended December 31, 2009 and 2008, 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 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 \$31,532,498 and \$41,152,603 in loans outstanding with MPF at December 31, 2009 and 2008, 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	
	2009	2008
<hr/>		
Financial instruments whose contract amount represent credit risk:		
Commitments to extend credit and available lines of credit	\$32,355,153	\$33,029,880
Standby letters of credit and commercial letters of credit	\$294,200	\$237,000
MPF credit enhancement obligation	\$ 1,222,586	\$ 1,073,142

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.

**Note 17. Transactions with Related Parties** (continued)

At December 31, 2009 and 2008, loans to the parties mentioned above are as follows:

	2009	2008
Balance, beginning	\$321,208	\$791,419
Additions	104,895	-
Repayments	(41,518)	(470,211)
Balance, ending	\$384,585	\$321,208

Total deposits to related parties approximated \$527,403 and \$808,342 on December 31, 2009 and 2008, respectively. Amounts due officers and directors under non-qualified deferred compensation agreements amounts to \$1,193,500 and \$1,090,287 at December 31, 2009 and 2008, respectively.

**Note 18. Fair Value of Financial Instruments**

The estimated fair values of the Bank's financial instruments at December 31, 2009 and 2008, are as follows:

	2009		2008	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial Assets:				
Cash and cash equivalents	\$ 3,889,515	\$ 3,889,515	\$ 4,325,720	\$ 4,325,720
Investment securities	50,326,494	50,373,369	40,466,672	40,484,691
Other short-term investments	13,921,344	13,921,344	7,532,526	7,532,526
Restricted equity securities	1,748,100	1,748,100	1,748,100	1,748,100
Loans, net of allowance	186,121,774	195,862,268	181,750,824	188,491,037
Accrued interest receivable	1,039,926	1,039,926	1,115,668	1,115,668
Financial liabilities:				
Deposits	\$226,078,884	\$226,845,818	\$204,085,480	\$204,824,461
Repurchase agreements	10,485,486	10,485,486	9,935,093	9,935,093
Borrowed funds	14,152,014	17,838,612	17,178,859	17,542,865
Accrued interest payable	89,848	89,848	123,428	123,428

The fair market value for all financial instruments 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, 2009 and 2008.

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

Fair values of assets and liabilities measured on a recurring basis at December 31, 2009 and 2008 are as follows:

	Fair Value	Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets/ Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2009				
Available-for-sale securities	\$49,240,727	\$ -	\$49,240,727	\$ -
December 31, 2008				
Available-for-sale securities	\$38,370,914	\$ -	\$38,370,914	\$ -

## 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, 2009, that the Corporation and the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2009, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework 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 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, 2009						
Total capital (to risk weighted assets)						
Consolidated	\$25,117	13.0%	\$15,457	8.0%	N/A	N/A
Bank	\$23,291	12.2%	\$15,307	8.0%	\$19,134	10.0%
Tier 1 capital (to risk weighted assets)						
Consolidated	\$22,708	11.8%	\$7,728	4.0%	N/A	N/A
Bank	\$20,899	10.9%	\$7,654	4.0%	\$11,480	6.0%
Tier 1 capital (to average assets)						
Consolidated	\$22,708	8.4%	\$10,822	4.0%	N/A	N/A
Bank	\$20,899	7.8%	\$10,708	4.0%	\$13,385	5.0%
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%

**Note 19. Regulatory Matters (continued)**

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 \$241,000 and \$247,000 at December 31, 2009 and 2008, respectively. In addition, the Bank contracted to maintain clearing balances of \$100,000 at December 31, 2009 and 2008.

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 that account.

**Note 21. Subsequent Events**

The Bank has evaluated all subsequent events through February 3, 2010, the date the financial statements were available to be issued.

**Note 22. Reclassification**

Certain 2008 amounts were reclassified to conform to 2009 presentation.