PEOPLES FINANCIAL SERVICES CORP.
Form 10-Q
August 10, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

Form 10-Q

(X) Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended June 30, 2009 or

( ) Transition report pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934 for the transition period from

No. 0-23863
(Commission File Number)

PEOPLES FINANCIAL SERVICES CORP.
(Exact Name of Registrant as Specified in its Charter)

Pennsylvania (State of Incorporation)	23-2391852 (IRS Employer ID Number)
82 Franklin Avenue Hallstead, PA (Address of Principal Executive Offices)	18822 (Zip Code)

(570) 879-2175
(Registrant's Telephone Number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months or for such shorter period that the registrant was required to file such reports, and (2) has been subject to such filing requirements for the past 90 days. Yes X No____

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes X No ____

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer __	Accelerated filer X	Non-accelerated filer __ (Do not check if smaller reporting company)	Smaller reporting company __

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ____ No X

Number of shares outstanding as of July 31, 2009

COMMON STOCK ($2 Par Value)	3,134,656
(Title of Class)	(Outstanding Shares)

PEOPLES FINANCIAL SERVICES CORP.
FORM 10-Q

For the Quarter Ended June 30, 2009

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

PEOPLES FINANCIAL SERVICES CORP.
CONSOLIDATED BALANCE SHEETS (UNAUDITED)
June 30, 2009 and December 31, 2008

(In thousands, except share and per share data)

ASSETS:	June 2009	Dec 2008
Cash and due from banks	$6,888	$6,174
Interest bearing deposits in other banks	769	1,782
Federal funds sold	5,597	10,577
Cash and cash equivalents	13,254	18,533
Securities available for sale	103,349	110,247
Loans	318,569	316,608
Allowance for loan losses	(2,928)	(3,002)
Loans, net	315,641	313,606
Bank premises and equipment, net	7,337	7,542
Accrued interest receivable	2,733	2,526
Intangible assets	689	818
Other real estate owned	5,440	5,171
Bank owned life insurance	8,081	7,911
Other assets	6,082	6,022
Total assets	$462,606	$472,376
LIABILITIES:		
Deposits:		
Non-interest bearing	$65,160	$55,324
Interest bearing	295,216	315,944
Total deposits	360,376	371,268
Accrued interest payable	438	1,649
Short-term borrowings	20,022	18,432
Long-term borrowings	39,191	39,691
Other liabilities	1,287	1,616
Total liabilities	421,314	432,656
STOCKHOLDERS' EQUITY:		
Common Stock, par value $2 per share; authorized 12,500,000 shares; issued 3,341,251 shares; outstanding 3,134,656 shares and 3,131,181 shares June 30, 2009 and December 31, 2008, respectively	6,683	6,683
Surplus	3,099	3,100
Retained earnings	40,959	39,375
Accumulated other comprehensive loss	(4,826)	(4,755)
Treasury stock at cost 206,595 and 210,070 shares at June 30, 2009 and December 31, 2008, respectively	(4,623)	(4,683)
Total stockholders' equity	41,292	39,720
Total liabilities and stockholders’ equity	$462,606	$472,376

See Notes to Consolidated Financial Statements

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PEOPLES FINANCIAL SERVICES CORP.
CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)

(In thousands, except share and per share data)

	Three Months Ended June 30 2009	Three Months Ended June 30 2008	Six Months Ended June 30 2009	Six Months Ended June 30 2008
INTEREST INCOME:				
Loans receivable, including fees	$4,880	$4,927	$9,724	$9,949
Securities:				
Taxable	693	974	1,517	1,940
Tax exempt	530	401	1,031	818
Other	5	6	20	12
Total interest income	6,108	6,308	12,292	12,719
INTEREST EXPENSE:				
Deposits	1,204	1,631	2,866	3,491
Short-term borrowings	85	69	152	201
Long-term borrowings	404	448	806	890
Total interest expense	1,693	2,148	3,824	4,582
Net interest income	4,415	4,160	8,468	8,137
PROVISION FOR LOAN LOSSES	1,040	135	1,205	255
Net interest income after provision for loan losses	3,375	4,025	7,263	7,882
OTHER INCOME:				
Customer service fees	479	509	929	978
Investment division commission income	119	76	225	160
Earnings on investment in life insurance	82	76	170	155
Other income	330	141	494	263
Net realized gains (losses) on sales of securities available for sale	339	(10)	518	16
Other than temporary security impairment	(60)	(83)	(136)	(265)
Total other income	1,289	709	2,200	1,307
OTHER EXPENSES:				
Salaries and employee benefits	1,365	1,130	2,706	2,340
Occupancy	200	174	439	372
Equipment	131	114	275	239
FDIC insurance and assessments	453	38	544	75
Professional fees and outside services	138	115	276	285
Computer services and supplies	279	230	526	461
Taxes, other than payroll and income	114	87	210	177
Amortization expense-deposit acquisition premiums	64	64	129	129
Stationary and printing supplies	93	92	183	170
Other	381	470	851	927
Total other expenses	3,218	2,514	6,139	5,175
Income before income taxes	1,446	2,220	3,324	4,014
INCOME TAXES	193	516	550	895
Net income	$1,253	$1,704	$2,774	$3,119
Net income per share, basic	$0.40	$0.54	$0.89	$1.00

Net income per share, diluted	$0.40	$0.54	$0.89	$1.00

See Notes to Consolidated Financial Statements

PEOPLES FINANCIAL SERVICES CORP.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
FOR THE SIX MONTHS ENDED JUNE 30, 2009 AND 2008
(UNAUDITED)

(In thousands except share data)	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total
Balance, December 31, 2008	$6,683	$3,100	$39,375	$ (4,755)	$(4,683)	$39,720
Comprehensive income						
Net income	0	0	2,774	0	0	2,774
Net change in unrealized losses on securities available for sale, net of reclassification adjustment and taxes	0	0	0	(71)	0	(71)
Total comprehensive income						2,703
Cash dividends, ($0.38 per share)	0	0	(1,190)	0	0	(1,190)
Treasury stock issued for stock option plan (3,475 shares)	0	(1)	0	0	60	59
Balance, June 30, 2009	$6,683	$3,099	$40,959	$ (4,826)	$(4,623)	$41,292
Balance, December 31, 2007	$6,683	$3,083	$38,824	$ (1,390)	$(4,395)	$42,805
Cumulative effect of adoption of new accounting principle on January 1, 2008	0	0	(71)	0	0	(71)
Comprehensive income						
Net income	0	0	3,119	0	0	3,119
Net change in unrealized losses on securities available for sale, net of reclassification adjustment and taxes	0	0	0	(2,542)	0	(2,542)
Total comprehensive income						577
Stock option expense	0	1	0	0	0	1
Cash dividends, ($0.38 per share)	0	0	(1,226)	0	0	(1,226)
Treasury stock purchase (20,000 shares)	0	0	0	0	(506)	(506)
Treasury stock issued for stock option plan (9,688 shares)	0	9	0	0	167	176
Balance, June 30, 2008	$6,683	$3,093	$40,646	$ (3,932)	$(4,734)	$41,756

See Notes to Consolidated Financial Statements

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PEOPLES FINANCIAL SERVICES CORP.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

(In thousands)	Six Months Ended	
	June 30, 2009	June 30, 2008
Cash Flows from Operating Activities		
Net income	$ 2,774	$ 3,119
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	479	430
Provision for loan losses	1,205	255
Gain on sale of other real estate owned	0	(15)
Amortization of securities' premiums and accretion of discounts, net	129	82
Amortization of deferred loan costs	165	176
Gains on sales of securities available for sale, net	(518)	(16)
Other than temporary security impairment	136	265
Stock option expense	0	1
Proceeds from the sale of loans originated for sale	16,140	3,420
Net gain on sale of loans originated for sale	(165)	(35)
Loans originated for sale	(12,840)	(3,258)
Net earnings on investment in life insurance	(170)	(155)
Increase in accrued interest receivable	(207)	(519)
Increase in other assets	(24)	(89)
Increase (decrease) in accrued interest payable	(1,211)	276
Decrease in other liabilities	(329)	(585)
Net cash provided by operating activities	5,564	3,352
Cash Flows from Investing Activities		
Proceeds from sale of available for sale securities	27,804	46,018
Proceeds from maturities of and principal payments received on available for sale securities	7,054	4,273
Purchase of available for sale securities	(27,814)	(52,875)
Net increase in loans	(6,767)	(7,439)
Purchase of premises and equipment	(145)	(788)
Investment in other real estate owned	(42)	0
Proceeds from sale of other real estate owned	0	180
Net cash provided by (used in) investing activities	90	(10,631)
Cash Flows from Financing Activities		
Cash dividends paid	(1,190)	(1,226)
Increase (decrease) in deposits	(10,892)	11,446
Proceeds from long-term borrowings	0	5,000
Repayment of long-term borrowings	(500)	(718)
Increase (decrease) in short-term borrowings	1,590	(5,224)
Purchase of treasury stock	0	(506)
Proceeds from sale of treasury stock	59	176
Net cash provided by (used in) financing activities	(10,933)	8,948
Net increase (decrease) in cash and cash equivalents	(5,279)	1,669
Cash and cash equivalents, beginning of year	18,533	8,606

Cash and cash equivalents, end of period	$	13,254	$	10,275
Supplemental disclosures of cash paid				
Interest paid	$	5,035	$	4,306
Income taxes paid	$	815	$	1,030
Non-cash investing and financing activities				
Transfers from loans to other real estate owned through foreclosure	$	227	$	99
Consideration received for exchange of securities available for sale (see page 34)	$	526	$	0

See Notes to Consolidated Financial Statements

NOTE 1. BASIS OF PRESENTATION

The consolidated financial statements include the accounts of Peoples Financial Services Corp. (the “Corporation” or the “Company”) and its wholly owned subsidiaries, Peoples National Bank (the “Bank”), Peoples Advisors, LLC (“Advisors”), and Peoples Financial Capital Corporation. The Bank has two wholly owned subsidiaries, Peoples Financial Leasing, LLC and Peoples Investment Holdings, LLC. All material inter-company accounts and transactions have been eliminated in consolidation.

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information as well as with instructions for Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included and are of a normal, recurring nature. Operating results for the six-month period ended June 30, 2009 are not necessarily indicative of the results that may be expected for the year ended December 31, 2009. For further information, refer to the consolidated financial statements and footnotes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2008.

Effective April 1, 2009, the Company adopted Statement of Financial Accounting Standards (“SFAS”) No. 165, Subsequent Events. SFAS No. 165 establishes general standards for accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued. SFAS No. 165 sets forth the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition in the financial statements, identifies the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and the disclosures that should be made about events or transactions that occur after the balance sheet date. In preparing these consolidated financial statements, the Company evaluated the events and transactions that occurred between June 30, 2009 through August 10, 2009, the date these consolidated financial statements were issued.

NOTE 2. EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share:

	Three Months Ended		Six Months Ended	
	June 30, 2009	June 30, 2008	June 30, 2009	June 30, 2008
Net income applicable to common stock	$1,253,000	$1,704,000	$2,774,000	$3,119,000
Weighted average common shares outstanding	3,133,480	3,126,855	3,132,353	3,125,284
Effect of dilutive securities, stock options	120	5,139	274	6,058
Weighted average common shares outstanding used to calculate diluted earnings per share	3,133,600	3,131,994	3,132,627	3,131,342
Basic earnings per share	$0.40	$0.54	$0.89	$1.00
Diluted earnings per share	$0.40	$0.54	$0.89	$1.00

Stock options for 23,429 and 11,959 shares of common stock were not considered in computing diluted earnings per share for the three and six months ended June 30, 2009 and for the three and six months ended June 30, 2008, respectively because they are antidilutive.

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NOTE 3. SECURITIES AVAILABLE FOR SALE

At June 30, 2009 and December 31, 2008, the amortized cost and fair values of securities available-for-sale are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(In Thousands)		
June 30, 2009:				
U.S. Government agencies and corporations	$15,239	$45	$(351)	$14,933
Obligations of state and political subdivisions	52,718	170	(2,769)	50,119
Taxable obligations of state and political subdivisions	5,759	24	(214)	5,569
Corporate debt securities	20,827	18	(3,839)	17,006
Mortgage-backed securities	11,422	239	(45)	11,616
Preferred equity securities	78	0	(36)	42
Common equity securities	4,618	13	(567)	4,064
Total	$110,661	$509	$(7,821)	$103,349
December 31, 2008:				
U.S. Government agencies and corporations	$7,891	$67	$0	$7,958
Obligations of state and political subdivisions	47,914	120	(3,319)	44,715
Taxable obligations of state and political subdivisions	3,166	0	(106)	3,060
Corporate debt securities	20,828	40	(3,898)	16,970
Mortgage-backed securities	32,487	325	(47)	32,765
Preferred equity securities	78	0	(58)	20
Common equity securities	5,086	0	(327)	4,759
Total	$117,450	$552	$(7,755)	$110,247

The amortized cost and fair value of securities as of June 30, 2009, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to prepay obligations with or without any penalties.

	Amortized Cost	Fair Value
	(In Thousands)	
Due in one year or less	$ 1,321	$ 1,324
Due after one year through five years	6,689	5,844
Due after five years through ten years	29,970	27,115
Due after ten years	56,563	53,344
	94,543	87,627
Mortgage-backed securities	11,422	11,616
Equity securities	4,696	4,106
	$ 110,661	$ 103,349

Proceeds from sale of available-for-sale securities during the six months ended June 30, 2009 and 2008 and the year ended December 31, 2008 were $27,804,000, $46,018,000, and $57,997,000, respectively. Gross gains realized on these sales were $280,000, $298,000, and $412,000, respectively. Gross losses on these sales were $9,000, $268,000, and $284,000, respectively.

Securities with a carrying value of $42,493,000 and $44,313,000 at June 30, 2009 and December 31, 2008, respectively, were pledged to secure public deposits and repurchase agreements as required or permitted by law.

The following tables show the Company's investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at June 30, 2009 and December 31, 2008 (in thousands):

June 30, 2009:

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Government agencies and corporations	$11,953	$(351)	$0	$0	$11,953	$(351)
Obligations of state and political subdivisions	15,754	(338)	25,393	(2,431)	41,147	(2,769)
Taxable obligations of state and political subdivisions	3,085	(82)	866	(132)	3,951	(214)
Corporate debt securities	734	(23)	14,512	(3,816)	15,246	(3,838)
Mortgage-backed securities	4,275	(44)	158	(1)	4,433	(45)
Preferred equity securities	42	(36)	0	0	42	(36)
Common equity securities	37	(113)	588	(454)	625	(567)
Total Temporarily Impaired Securities	$35,880	$(987)	$41,517	$(6,834)	$77,397	$(7,821)

December 31, 2008:

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of state and political subdivisions	$34,301	$(2,376)	$2,570	$(943)	$36,871	$(3,319)
Taxable obligations of state and political subdivisions	3,060	(106)	0	0	3,060	(106)
Corporate debt securities	8,752	(2,878)	7,420	(1,020)	16,172	(3,898)
Mortgage-backed securities	11,242	(41)	1,305	(6)	12,547	(47)
Preferred equity securities	20	(58)	0	0	20	(58)
Common equity securities	166	(37)	687	(290)	853	(327)
Total Temporarily Impaired Securities	$57,541	$(5,496)	$11,982	$(2,259)	$69,523	$(7,755)

As of June 30, 2009 the Company had 8 (all less than 12 months) U.S. Government Agency securities, 80 (46 less than 12 months, 34 greater than 12 months) obligations of state and political subdivisions, 11 (1 less than 12 months, 10 greater than 12 months) corporate debt securities, 6 (3 less than 12 months, 3 greater than 12 months) mortgage-backed securities, 2 (both less than 12 months) preferred equity securities and 17 (1 less than 12 months, 16 greater than 12 months) common equity securities in an unrealized loss position. The majority of the unrealized losses reflect changes in interest rates subsequent to the acquisition of the specific securities and management believes that these unrealized losses represent a temporary impairment of those securities. As long-term rates increase, the underlying value of securities owned by the Company decreases, creating an unrealized loss.

The Company recorded other than temporary impairments of $136,000 for the six months ended June 30, 2009. These impairments were the result of writing down two separate common equity securities. These write-downs were measured based on public market prices. In reaching the determination to record these impairments, management reviewed the facts and circumstances available surrounding the securities, including the duration and amount of the unrealized loss, the financial condition of the issuer and the prospects for a change in market value within a reasonable period of time. Based on its assessment, management determined that the impairment was other-than-temporary and that a charge was appropriate for these securities.

Management evaluates securities for other-than-temporary impairment ("OTTI") at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. All of the Company's investment securities classified as available-for-sale are evaluated for OTTI under SFAS 115, Accounting for Certain Investments in Debt and Equity Securities.

In determining OTTI under the SFAS 115 model, management considers many factors, including: (1) the length of time and the extent to which the fair value has been less than amortized cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the entity has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on information available to management at a point in time. An OTTI is deemed to have occurred if there has been an adverse change in the remaining expected future cash flows.

When an OTTI occurs under the model, the amount of the OTTI recognized in earnings depends on whether an entity intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss. If an entity intends to sell or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the OTTI shall be recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. If an entity does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis less any current-period loss, the OTTI shall be separated into the amount representing the credit loss and the amount related to all other factors. The amount of the total OTTI related to the credit loss is determined based on the present value of cash flows expected to be collected and is recognized in earnings. The amount of the total OTTI related to other factors shall be recognized in other comprehensive income, net of applicable tax benefit. The previous amortized cost basis less the OTTI recognized in earnings shall become the new amortized cost basis of the investment. As of June 30, 2009 the Company has the intent and ability to hold such securities until maturity or market price recovery. Management believes that the unrealized losses represent temporary impairment of the securities.

As a member of the Federal Home Loan Bank of Pittsburgh ("FHLB"), the Company is required to purchase and hold stock in the FHLB to satisfy membership and borrowing requirements. This stock is restricted in that it can only be sold to the FHLB or to another member institution, and all sales of FHLB stock must be at par. As a result of these restrictions, FHLB stock is unlike other investment securities insofar as there is no trading market for FHLB stock and the transfer price is determined by FHLB membership rules and not by market participants. As of June 30, 2009 and December 31, 2008, our FHLB stock totaled $2.771 million and $2.559 million, respectively.

In December 2008, the FHLB voluntarily suspended dividend payments on its stock, as well as the repurchase of excess stock from members. The FHLB cited a significant reduction in the level of core earnings resulting from lower short-term interest rates, the increased cost of liquidity, and constrained access to the debt markets at attractive rates and maturities as the main reasons for the decision to suspend dividends and the repurchase of excess capital stock. The FHLB last paid a dividend in the third quarter of 2008.

FHLB stock is held as a long-term investment and its value is determined based on the ultimate recoverability of the par value. The Company evaluates impairment quarterly. The decision of whether impairment exists is a matter of judgment that reflects our view of the FHLB's long-term performance, which includes factors such as the following:

- its operating performance;
- the severity and duration of declines in the fair value of its net assets related to its capital stock amount;
- its commitment to make payments required by law or regulation and the level of such payments in relation to its operating performance;
- the impact of legislative and regulatory changes on the FHLB, and accordingly, on the members of FHLB; and
- its liquidity and funding position.

After evaluating all of these considerations, the Company concluded that the par value of its investment in FHLB stock will be recovered. Accordingly, no impairment charge was recorded on these securities for the six and three months ended June 30, 2009. Our evaluation of the factors described above in future periods could result in the recognition of impairment charges on FHLB stock.

NOTE 4. OTHER COMPREHENSIVE INCOME

The components of other comprehensive income (loss) and related tax effects for the six months and three months ended June 30, 2009 and 2008 are as follows:

(In thousands)	Three Months Ended		Six Months Ended	
	June 30, 2009	June 30, 2008	June 30, 2009	June 30, 2008
Unrealized holding gains (losses) on available for sale securities	$ 1,644	$ (2,259)	$ 275	$ (4,100)
Less: Reclassification adjustment for (gains) losses realized in net income	(339)	10	(518)	(16)
Less: Reclassification adjustment for other than temporary impairment	60	83	136	265
Net unrealized gains (losses)	1,365	(2,166)	(107)	(3,851)
Tax effect	465	736	(36)	(1,309)
Other comprehensive income (loss)	$ 900	$ (1,430)	$ (71)	$ (2,542)

NOTE 5. STOCK-BASED COMPENSATION

As of June 30, 2009, all stock options were fully vested and there are no unrecognized compensation costs related to stock options. For the six month periods ending June 30, 2009 and 2008, respectively, there were no stock options granted.

NOTE 6. GUARANTEES

The Company does not issue any guarantees that would require liability recognition or disclosure, other than standby letters of credit. Outstanding letters of credit written are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for standby letters of credit is represented by the contractual amount of those instruments. The Company had $11.443 million of standby letters of credit as of June 30, 2009. The Bank uses the same credit policies in making conditional obligations as it does for on-balance sheet instruments.

The majority of these standby letters of credit expire within the next twelve months. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending other loan commitments. The Company requires collateral supporting these letters of credit as deemed necessary. The maximum undiscounted exposure related to these commitments at June 30, 2009 was $11.443 million and the approximate value of underlying collateral upon liquidation, that would be expected to cover this maximum potential exposure, was $10.368 million.

NOTE 7. NEW ACCOUNTING STANDARDS

In April 2009, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) No. FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly (FSP FAS 157-4). FASB Statement 157, Fair Value Measurements, defines fair value as the price that would be received to sell the asset or transfer the liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. FSP FAS 157-4 provides additional guidance on determining when the volume and level of activity for the asset or liability has significantly decreased. The FSP also includes guidance on identifying circumstances when a transaction may not be considered orderly.

FSP FAS 157-4 provides a list of factors that a reporting entity should evaluate to determine whether there has been a significant decrease in the volume and level of activity for the asset or liability in relation to normal market activity for the asset or liability. When the reporting entity concludes there has been a significant decrease in the volume and level of activity for the asset or liability, further analysis of the information from that market is needed and significant adjustments to the related prices may be necessary to estimate fair value in accordance with Statement 157.

This FSP clarifies that when there has been a significant decrease in the volume and level of activity for the asset or liability, some transactions may not be orderly. In those situations, the entity must evaluate the weight of the evidence to determine whether the transaction is orderly. The FSP provides a list of circumstances that may indicate that a transaction is not orderly. A transaction price that is not associated with an orderly transaction is given little, if any, weight when estimating fair value.

This FSP is effective for interim and annual reporting periods ending after June 15, 2009. The Company adopted this FSP for the quarter ended June 30, 2009. This FSP had no impact on the Company's consolidated financial statements upon adoption, although additional disclosures were required and are included in Note 8.

In April 2009, the FASB issued FSP No. FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments (FSP FAS 115-2 and FAS 124-2). FSP FAS 115-2 and FAS 124-2 clarifies the interaction of the factors that should be considered when determining whether a debt security is other-than-temporarily impaired. For debt securities, management must assess whether (a) it has the intent to sell the security and (b) it is more likely than not that it will be required to sell the security prior to its anticipated recovery. These steps are done before assessing whether the entity will recover the cost basis of the investment. Previously, this assessment required management to assert it has both the intent and the ability to hold a security for a period of time sufficient to allow for an anticipated recovery in fair value to avoid recognizing an other-than-temporary impairment. This change does not affect the need to forecast recovery of the value of the security through either cash flows or market price.

In instances when a determination is made that an other-than-temporary impairment exists but the investor does not intend to sell the debt security and it is not more likely than not that it will be required to sell the debt security prior to its anticipated recovery, FSP FAS 115-2 and FAS 124-2 changes the presentation and amount of the other-than-temporary impairment recognized in the income statement. The other-than-temporary impairment is separated into (a) the amount of the total other-than-temporary impairment related to a decrease in cash flows expected to be collected from the debt security (the credit loss) and (b) the amount of the total other-than-temporary impairment related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings. The amount of the total other-than-temporary impairment related to all other factors is recognized in other comprehensive income.

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This FSP is effective for interim and annual reporting periods ending after June 15, 2009. The Company adopted this FSP for the quarter ended June 30, 2009. This FSP had no impact on the Company's consolidated financial statements upon adoption.

In April 2009, the FASB issued FSP No. FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments (FSP FAS 107-1 and APB 28-1). FSP FAS 107-1 and APB 28-1 amends FASB Statement No. 107, Disclosures about Fair Value of Financial Instruments, to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. This FSP also amends APB Opinion No. 28, Interim Financial Reporting, to require those disclosures in summarized financial information at interim reporting periods.

This FSP is effective for interim and annual reporting periods ending after June 15, 2009. The Company adopted this FSP for the quarter ended June 30, 2009. This FSP had no impact on the Company's consolidated financial statements upon adoption, although additional disclosures were required and are included in Note 8.

In June 2009, the FASB issued SFAS No. 166, Accounting for Transfers of Financial Assets, an amendment of FASB Statement No. 140. This statement prescribes the information that a reporting entity must provide in its financial reports about a transfer of financial assets; the effects of a transfer on its financial position, financial performance and cash flows; and a transferor's continuing involvement in transferred financial assets. Specifically, among other aspects, SFAS 166 amends Statement of Financial Standard No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, or SFAS 140, by removing the concept of a qualifying special-purpose entity from SFAS 140 and removes the exception from applying FIN 46(R) to variable interest entities that are qualifying special-purpose entities. It also modifies the financial-components approach used in SFAS 140. SFAS 166 is effective for fiscal years beginning after November 15, 2009. The Company is currently reviewing the effect this new pronouncement will have on its consolidated financial statements.

In June 2009, the FASB issued SFAS No. 167, Amendments to FASB Interpretation No. 46(R). This statement amends FASB Interpretation No. 46, Consolidation of Variable Interest Entities (revised December 2003) — an interpretation of ARB No. 51, or FIN 46(R), to require an enterprise to determine whether it's variable interest or interests give it a controlling financial interest in a variable interest entity. The primary beneficiary of a variable interest entity is the enterprise that has both (1) the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance and (2) the obligation to absorb losses of the entity that could potentially be significant to the variable interest entity or the right to receive benefits from the entity that could potentially be significant to the variable interest entity. SFAS 167 also amends FIN 46(R) to require ongoing reassessments of whether an enterprise is the primary beneficiary of a variable interest entity. SFAS 167 is effective for fiscal years beginning after November 15, 2009. The Company is currently reviewing the effect this new pronouncement will have on its consolidated financial statements.

In June 2009, the FASB issued SFAS No. 168, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles, a replacement of FASB Statement No. 162. SFAS 168 replaces SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles, to establish the FASB Accounting Standards Codification as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in preparation of financial statements in conformity with generally accepted accounting principles in the United States. SFAS 168 is effective for interim and annual periods ending after September 15, 2009. We do not expect the adoption of this standard to have an impact on our financial position or results of operations.

NOTE 8. FAIR VALUE MEASUREMENTS

In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement No. 157, Fair Value Measurements ("SFAS 157"), which defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. SFAS 157 applies to other accounting pronouncements that require or permit fair value measurements. The Company adopted SFAS 157 effective for its fiscal years beginning January 1, 2008.

In December 2007, the FASB issued FASB Staff Position 157-2, Effective Date of FASB Statement No. 157 ("FSP 157-2"). FSP 157-2 delays the effective date of SFAS 157 for all non-financial assets and liabilities, except those that are recognized or disclosed at fair value on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008 and interim periods within those fiscal years. As such, the Company only partially adopted the provisions of SFAS 157 in 2008 and began to account and report for non-financial assets and liabilities in 2009. In October 2008, the FASB issued FASB Staff Position 157-3, Determining the Fair Value of a Financial Asset When the Market for that Asset is Not Active ("FSP 157-3"), to clarify the application of the provisions of SFAS 157 in an inactive market and how an entity would determine fair value in an inactive market. The adoption of SFAS 157 and FSP 157-3 had no impact on the amounts reported in the consolidated financial statements.

SFAS 157 establishes a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under SFAS 157 are as follows:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.