

**CHAMPLAIN BANK CORPORATION  
AND SUBSIDIARY**

**CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2010 and 2009**

**With Independent Auditors' Report**

## INDEPENDENT AUDITORS' REPORT

The Board of Directors  
Champlain Bank Corporation and Subsidiary

We have audited the accompanying consolidated balance sheets of Champlain Bank Corporation and Subsidiary (the Company) as of December 31, 2010 and 2009, and the related consolidated statements of income, changes in stockholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with U.S. generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the 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 consolidated financial position of Champlain Bank Corporation and Subsidiary as of December 31, 2010 and 2009, and the consolidated results of their operations and their consolidated cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

*Berry, Dunn, McNeil & Parker*

Portland, Maine  
March 28, 2011

**CHAMPLAIN BANK CORPORATION  
AND SUBSIDIARY**

**Consolidated Balance Sheets**

**December 31, 2010 and 2009**

**ASSETS**

	<u>2010</u>	<u>2009</u>
Cash and cash equivalents		
Cash and due from banks	\$ 4,441,376	\$ 4,066,359
Federal funds sold	74,285	138,502
Securities available-for-sale	89,029,214	79,986,473
Securities held-to-maturity	971,377	453,580
Loans receivable, net of allowance for loan losses of \$1,835,595 in 2010 and \$1,908,963 in 2009	103,527,040	106,887,635
Accrued interest receivable	794,152	851,565
Federal Home Loan Bank stock, at cost	802,100	973,300
Premises and equipment, net	3,072,292	3,074,517
Prepaid FDIC assessment	607,785	892,373
Other real estate owned	937,242	-
Other assets	<u>8,154,021</u>	<u>7,167,641</u>
	<u>\$ 212,410,884</u>	<u>\$ 204,491,945</u>

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The accompanying notes are an integral part of these consolidated financial statements.

## LIABILITIES AND STOCKHOLDERS' EQUITY

	<u>2010</u>	<u>2009</u>
Liabilities		
Deposits	\$ 178,267,232	\$ 169,349,179
Advances from Federal Home Loan Bank	12,500,000	15,000,000
Accrued expenses and other liabilities	<u>5,623,064</u>	<u>4,774,936</u>
Total liabilities	<u>196,390,296</u>	<u>189,124,115</u>
Commitments and contingencies (Notes 5, 9, 10, 11, 14 and 15)		
Stockholders' equity		
Preferred stock, \$1 par value; 100,000 shares authorized; none issued		
Common stock, \$1 par value; 200,000 shares authorized; 28,284 shares issued; 24,211 shares outstanding at December 31, 2010 and 24,209 shares outstanding at December 31, 2009	28,284	28,284
Surplus	1,070,883	1,070,883
Retained earnings	17,519,292	16,411,729
Accumulated other comprehensive loss		
Net unrealized appreciation on securities available-for-sale, net of deferred income taxes	285,420	736,740
Net unrecognized loss on pension and other postretirement benefit costs, net of deferred income taxes	(1,589,874)	(1,585,455)
Treasury stock, at cost, 4,073 shares in 2010 and 4,075 shares in 2009	<u>(1,293,417)</u>	<u>(1,294,351)</u>
Total stockholders' equity	<u>16,020,588</u>	<u>15,367,830</u>
	<u>\$ 212,410,884</u>	<u>\$ 204,491,945</u>

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**CHAMPLAIN BANK CORPORATION  
AND SUBSIDIARY**

**Consolidated Statements of Income**

**Years Ended December 31, 2010 and 2009**

	<u>2010</u>	<u>2009</u>
Interest and dividend income		
Loans	\$ 6,080,091	\$ 6,247,792
Investment securities		
Taxable	2,863,374	2,907,448
Tax-exempt	798,641	751,443
Other interest-earning assets	<u>207</u>	<u>2,487</u>
Total interest and dividend income	<u>9,742,313</u>	<u>9,909,170</u>
Interest expense		
Deposits	951,241	1,458,938
Borrowed funds	<u>472,376</u>	<u>555,680</u>
Total interest expense	<u>1,423,617</u>	<u>2,014,618</u>
Net interest income	8,318,696	7,894,552
Provision for loan losses	<u>320,000</u>	<u>275,200</u>
Net interest income after provision for loan losses	<u>7,998,696</u>	<u>7,619,352</u>
Noninterest income		
Service charges and fees	1,492,874	1,609,857
Loan servicing fees	134,340	118,511
Net gain (loss) on sales of securities available-for-sale	55,351	(450,097)
Other	<u>280,149</u>	<u>316,439</u>
Total noninterest income before impairment of investment security	<u>1,962,714</u>	<u>1,594,710</u>
Total other-than-temporary impairment loss	(171,886)	(177,575)
Portion of loss recognized in other comprehensive loss	<u>43,686</u>	<u>52,575</u>
Net impairment loss recognized in net income	<u>(128,200)</u>	<u>(125,000)</u>
Net noninterest income	<u>1,834,514</u>	<u>1,469,710</u>
Noninterest expenses		
Salaries and employee benefits	4,668,696	4,645,846
Occupancy	599,795	633,918
Other general and administrative	<u>2,749,653</u>	<u>2,628,973</u>
Total noninterest expenses	<u>8,018,144</u>	<u>7,908,737</u>
Income before income taxes	1,815,066	1,180,325
Income tax expense	<u>392,760</u>	<u>146,860</u>
Net income	<u>\$ 1,422,306</u>	<u>\$ 1,033,465</u>
Basic and diluted earnings per share	<u>\$ 58.75</u>	<u>\$ 42.69</u>

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The accompanying notes are an integral part of these consolidated financial statements.

**CHAMPLAIN BANK CORPORATION  
AND SUBSIDIARY**

**Consolidated Statements of Changes in Stockholders' Equity**

**Years Ended December 31, 2010 and 2009**

	<u>Common Stock</u>	<u>Surplus</u>	<u>Retained Earnings</u>	<u>Net Unrealized Appreciation (Depreciation) On Securities Available- for-Sale</u>	<u>Net Unrecognized Loss on Pension and Other Postretire- ment Benefit Costs</u>	<u>Treasury Stock</u>	<u>Total</u>
Balance, December 31, 2008	\$ 28,284	\$ 1,070,883	\$ 15,692,981	\$ (868,800)	\$ (2,351,066)	\$(1,294,351)	\$12,277,931
Net income	-	-	1,033,465	-	-	-	1,033,465
Unrealized holding gains arising during the period, net of deferred income tax of \$(840,320)	-	-	-	1,260,483	-	-	1,260,483
Reclassification adjustment for losses included in net income, net of deferred income tax of \$(230,040)	-	-	-	345,057	-	-	345,057
Change in net unrealized depreciation on securities available-for-sale, net of deferred income tax of \$(1,070,360)	-	-	-	1,605,540	-	-	1,605,540
Unrecognized actuarial gain on pension and postretirement benefits, net of deferred income tax of \$(510,413)	-	-	-	-	765,611	-	765,611
Total comprehensive income	-	-	1,033,465	1,605,540	765,611	-	3,404,616
Cash dividends declared	-	-	(314,717)	-	-	-	(314,717)
Balance, December 31, 2009	\$ 28,284	\$ 1,070,883	\$ 16,411,729	\$ 736,740	\$ (1,585,455)	\$(1,294,351)	\$15,367,830

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The accompanying notes are an integral part of these consolidated financial statements.

**CHAMPLAIN BANK CORPORATION  
AND SUBSIDIARY**

**Consolidated Statements of Changes in Stockholders' Equity**

**Years Ended December 31, 2010 and 2009**

	<u>Common Stock</u>	<u>Surplus</u>	<u>Retained Earnings</u>	<u>Net Unrealized Appreciation (Depreciation) On Securities Available- for-Sale</u>	<u>Net Unrecognized Loss on Pension and Other Postretire- ment Benefit Costs</u>	<u>Treasury Stock</u>	<u>Total</u>
Balance, December 31, 2009	\$ 28,284	\$ 1,070,883	\$ 16,411,729	\$ 736,740	\$ (1,585,455)	\$(1,294,351)	\$15,367,830
Net income	-	-	<u>1,422,306</u>	-	-	-	<u>1,422,306</u>
Unrealized holding losses arising during the period, net of deferred income tax of \$330,020	-	-	-	(495,029)	-	-	(495,029)
Reclassification adjustment for losses included in net income, net of deferred income tax of \$(29,140)	-	-	-	<u>43,709</u>	-	-	<u>43,709</u>
Change in net unrealized appreciation on securities available-for-sale, net of deferred income tax of \$300,880	-	-	-	(451,320)	-	-	(451,320)
Unrecognized actuarial loss on pension and postretirement benefits, net of deferred income tax of \$(2,803)	-	-	-	-	(4,419)	-	(4,419)
Total comprehensive income	-	-	<u>1,422,306</u>	<u>(451,320)</u>	<u>(4,419)</u>	-	<u>966,567</u>
Issuance of treasury stock (2 shares)	-	-	-	-	-	934	934
Cash dividends declared	-	-	<u>(314,743)</u>	-	-	-	<u>(314,743)</u>
Balance, December 31, 2010	<u>\$ 28,284</u>	<u>\$ 1,070,883</u>	<u>\$ 17,519,292</u>	<u>\$ 285,420</u>	<u>\$ (1,589,874)</u>	<u>\$(1,293,417)</u>	<u>\$16,020,588</u>

The accompanying notes are an integral part of these consolidated financial statements.

**CHAMPLAIN BANK CORPORATION  
AND SUBSIDIARY**

**Consolidated Statements of Cash Flows**

**Years Ended December 31, 2010 and 2009**

	<u>2010</u>	<u>2009</u>
Cash flows from operating activities		
Net income	\$ 1,422,306	\$ 1,033,465
Adjustments to reconcile net income to net cash provided (used) by operating activities		
Depreciation	465,639	468,199
Amortization of discounts and premiums on investments	148,755	68,359
Provision for loan losses	320,000	275,200
Impairment of security	128,200	125,000
Net realized (gain) loss on sales of securities available-for-sale	(55,351)	450,097
Write-down of other real estate owned	52,560	-
Gain on sale of other real estate owned	(12,417)	-
Deferred income tax	203,529	568,700
Decrease in accrued interest receivable	57,413	60,017
Increase in other assets	(893,448)	(279,841)
Decrease (increase) in prepaid FDIC assessment	284,588	(892,373)
Increase (decrease) in accrued expenses and other liabilities	848,128	(2,113,475)
Net cash provided (used) by operating activities	<u>2,969,902</u>	<u>(236,652)</u>
Cash flows from investing activities		
Additions to premises and equipment	(463,414)	(377,437)
Loan originations and principal collections, net	1,930,793	(3,758,063)
Net decrease (increase) in federal funds sold	64,217	(120,762)
Redemption (purchase) of Federal Home Loan Bank stock	171,200	(3,800)
Purchase of securities available-for-sale	(43,884,381)	(20,354,619)
Proceeds from sales of securities available-for-sale	6,884,061	4,344,235
Proceeds from the sale of other real estate owned	132,417	-
Maturities of securities available-for-sale	26,983,775	12,239,720
Purchase of securities held-to-maturity	(658,823)	(10,880)
Maturities of securities held-to-maturity	141,026	144,000
Net cash used by investing activities	<u>(8,699,129)</u>	<u>(7,897,606)</u>
Cash flows from financing activities		
Net increase in deposits	8,918,053	9,402,275
Net increase (decrease) in short-term borrowings	2,500,000	(1,500,000)
Repayment of long-term borrowings	(5,000,000)	-
Payments to acquire treasury stock	934	-
Cash dividends paid on common stock	(314,743)	(314,717)
Net cash provided by financing activities	<u>6,104,244</u>	<u>7,587,558</u>
Net increase (decrease) in cash and cash equivalents	375,017	(546,700)
Cash and cash equivalents, beginning of year	<u>4,066,359</u>	<u>4,613,059</u>
Cash and cash equivalents, end of year	<u>\$ 4,441,376</u>	<u>\$ 4,066,359</u>
Supplementary cash flow information:		
Interest paid on deposits and borrowed funds	<u>\$ 1,472,922</u>	<u>\$ 2,102,592</u>
Income taxes paid	<u>\$ -</u>	<u>\$ 445,620</u>
Noncash transactions:		
Transfers from loans to other real estate owned	<u>\$ 1,109,802</u>	<u>\$ -</u>

The accompanying notes are an integral part of these consolidated financial statements.

# CHAMPLAIN BANK CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements

December 31, 2010 and 2009

### Nature of Business

Champlain Bank Corporation (the Company) is a one-bank holding company organized in 1986 and headquartered in Willsboro, New York. It provides a variety of financial services to individuals and small businesses through its offices in the Essex and Clinton Counties of New York. Its primary deposit products are demand, savings and term certificate accounts and its primary lending products are consumer and commercial mortgage loans. The Company is subject to the regulations of certain federal and state agencies as well as examinations by those regulatory authorities.

### 1. Summary of Significant Accounting Policies

#### Basis of Presentation and Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Champlain National Bank (the Bank). All significant intercompany balances and transactions have been eliminated in consolidation.

The Company follows accounting standards as set by the Financial Accounting Standards Board (FASB). The FASB sets U.S. generally accepted accounting principles (GAAP) that management follows to help ensure they consistently report the Company's financial condition, results of operations and cash flows.

#### Use of Estimates

In preparing consolidated financial statements in conformity with GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the balance sheet and 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 change in the near term relate to the determination of the allowance for loan losses and the valuation of other real estate owned. In connection with the determination of the allowance for loan losses and the carrying value of other real estate owned, management obtains independent appraisals for significant properties.

# CHAMPLAIN BANK CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements

December 31, 2010 and 2009

### Significant Group Concentrations of Credit Risk

Most of the Company's loans are collateralized by real estate in the Essex and Clinton Counties of New York. Accordingly, the ultimate collectability of a substantial portion of the Company's loan portfolio is susceptible to changes in economic conditions in these areas.

### Cash and Cash Equivalents

For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash and due from banks.

The Company's due from bank accounts, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts. The Company believes it is not exposed to any significant risk on cash and cash equivalents.

### Securities

Debt securities that management has the positive intent and ability to hold to maturity are classified as "held-to-maturity" and recorded at amortized cost. Securities not classified as held-to-maturity, including equity securities with readily determinable fair values, are classified as "available-for-sale" and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income or loss, net of related income taxes.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value individual equity securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. For declines in the fair value of individual debt securities available-for-sale below their cost that are deemed to be other than temporary, where the Company does not intend to sell the security and it is more likely than not that the Company will not be required to sell the security before recovery of its amortized cost basis, the other-than-temporary decline in the fair value of the debt security related to 1) credit loss is recognized in earnings, and 2) other factors are recognized in other comprehensive income or loss. Credit loss is deemed to exist if the present value of expected future cash flows using the effective rate at acquisition is less than the amortized cost basis of the debt security. For individual debt securities where the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost, the other-than-temporary impairment is recognized in earnings equal to the entire difference between the security's cost basis and its fair value at the balance sheet date.

Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

# CHAMPLAIN BANK CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements

December 31, 2010 and 2009

Nonmarketable equity securities, such as Federal Home Loan Bank of New York stock and Federal Reserve Bank of New York stock, are stated at cost and are included in other assets. These securities are periodically evaluated for impairment. The investments in Federal Home Loan Bank of New York stock and Federal Reserve Bank of New York stock are required for membership.

### Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally are reported at their outstanding unpaid principal balances adjusted for charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method.

Loans past due 30 days or more are considered delinquent. The accrual of interest on mortgage and commercial loans is discontinued at the time the loan is 90 days delinquent unless the credit is well secured and in process of collection. Personal loans are typically charged off no later than 180 days past due. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued, but not collected, for loans that are placed on nonaccrual or charged off is reversed against interest income. Cash payments representing interest income are reported as such. Other cash payments are reported as reductions in carrying value. Increases or decreases in the carrying value, due to changes in estimates of future payments and due to the passage of time, are reported as provision for loan losses. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

### Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

# CHAMPLAIN BANK CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements

December 31, 2010 and 2009

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as doubtful, substandard or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest, when due, according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for commercial loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer loans for impairment disclosures.

### **Credit Related Financial Instruments**

In the ordinary course of business, the Company has entered into commitments to extend credit, including commitments under lines-of-credit. Such financial instruments are recorded when they are funded.

### **Other Real Estate Owned**

Assets acquired through, or in lieu of, loan foreclosure are held-for-sale and are initially recorded at fair value at the date of foreclosure, establishing a new cost basis. Losses arising from the acquisition of such property are charged against the allowance for loan losses. After foreclosure, these assets are carried at the lower of their new cost basis or fair value less cost to sell.

Revenues and expenses from operations and changes in the valuation allowance are included in net expenses from other real estate owned in other general and administrative expenses.

# CHAMPLAIN BANK CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements

December 31, 2010 and 2009

### Premises and Equipment

Land is carried at cost. Buildings and equipment are carried at cost, less accumulated depreciation computed on the straight-line and various accelerated methods over the estimated useful lives of the assets. Leasehold improvements are amortized over the lesser of the life of the improvement or the related lease term.

### Earnings Per Share

Basic earnings per share is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period. The Company has a simple capital structure with no dilutive or potentially dilutive instruments outstanding as of December 31, 2010 and 2009. The weighted average number of shares outstanding for both basic and diluted earnings per share calculations was 24,211 in 2010 and 24,209 in 2009.

### Income Taxes

Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws.

FASB Accounting Standards Codification (ASC) 740, *Income Taxes*, defines the criteria that an individual tax position must satisfy for some or all of the benefits of that position to be recognized in a company's financial statements. ASC 740 prescribes a recognition threshold of more-likely-than-not, and a measurement attribute for all tax positions taken or expected to be taken on a tax return, in order for those tax positions to be recognized in the financial statements. The Company has adopted these provisions and there was no material effect on the financial statements. The Company is currently open to audit under the statute of limitations by the Internal Revenue Service for the year ended December 31, 2009. It is the Company's policy to record interest and penalties to income tax expense.

### Comprehensive Income or Loss

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 appreciation and depreciation on securities available-for-sale, are reported as a separate component of the equity section of the consolidated balance sheet, such items, along with net income, are components of comprehensive income or loss.

**CHAMPLAIN BANK CORPORATION AND SUBSIDIARY**

**Notes to Consolidated Financial Statements**

**December 31, 2010 and 2009**

**Reclassifications**

Certain amounts in the 2009 financial statements have been reclassified to conform to the 2010 presentation.

**2. Cash and Due from Banks**

The Company is required to maintain certain reserves of vault cash or deposits with the Federal Reserve Bank. The amount of this reserve requirement, included in cash and due from banks, was approximately \$380,000 and \$440,000 as of December 31, 2010 and 2009, respectively.

**3. Securities**

The amortized cost and fair value of securities as of December 31 are as follows:

		<u>2010</u>		
	<u>Amortized</u>	<u>Gross</u>	<u>Gross</u>	<u>Fair</u>
	<u>Cost</u>	<u>Unrealized</u>	<u>Unrealized</u>	<u>Value</u>
		<u>Gains</u>	<u>Losses</u>	
<u>Securities Available-for-Sale</u>				
Debt securities				
U.S. Government and government sponsored enterprises	\$ 534,805	\$ 18,020	\$ -	\$ 552,825
State and municipal	22,485,060	144,230	607,247	22,022,043
Corporate	927,222	-	146,093	781,129
Mortgage-backed securities	56,252,890	1,477,470	426,487	57,303,873
Collateral mortgage obligations	<u>8,353,537</u>	<u>371,521</u>	<u>355,714</u>	<u>8,369,344</u>
Total securities available-for-sale	<u>\$88,553,514</u>	<u>\$2,011,241</u>	<u>\$ 1,535,541</u>	<u>\$89,029,214</u>
<u>Securities Held-to-Maturity</u>				
Debt securities				
State and municipal	\$ 971,377	\$ 3,655	\$ 12,415	\$ 962,617
Total securities available-for-sale	<u>\$ 971,377</u>	<u>\$ 3,655</u>	<u>\$ 12,415</u>	<u>\$ 962,617</u>

**CHAMPLAIN BANK CORPORATION AND SUBSIDIARY**

**Notes to Consolidated Financial Statements**

**December 31, 2010 and 2009**

		<u>2009</u>		
	<u>Amortized</u>	<u>Gross</u>	<u>Gross</u>	<u>Fair</u>
	<u>Cost</u>	<u>Unrealized</u>	<u>Unrealized</u>	<u>Value</u>
		<u>Gains</u>	<u>Losses</u>	
<u>Securities Available-for-Sale</u>				
Debt securities				
U.S. Government and government sponsored enterprises	\$ 9,928,026	\$ 35,118	\$ 4,988	\$ 9,958,156
State and municipal	20,789,712	290,666	205,492	20,874,886
Corporate	924,860	-	213,473	711,387
Mortgage-backed securities	37,852,499	1,504,346	22,078	39,334,767
Collateral mortgage obligations	<u>9,263,476</u>	<u>202,402</u>	<u>358,601</u>	<u>9,107,277</u>
Total securities available-for-sale	<u>\$78,758,573</u>	<u>\$2,032,532</u>	<u>\$ 804,632</u>	<u>\$79,986,473</u>
<u>Securities Held-to-Maturity</u>				
Debt securities				
State and municipal	\$ <u>453,580</u>	\$ <u>34,685</u>	\$ _____	\$ <u>488,265</u>
Total securities available-for-sale	<u>\$ 453,580</u>	<u>\$ 34,685</u>	<u>\$ _____</u>	<u>\$ 488,265</u>

At December 31, 2010 and 2009, securities with a carrying value of \$76,997,007 and \$68,983,495, respectively, were pledged to secure public deposits and for other purposes required or permitted by law.

The amortized cost and fair value of debt securities by contractual maturity at December 31, 2010, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without penalties.

	<u>Available-for-Sale</u>		<u>Held-to-Maturity</u>	
	<u>Amortized</u>	<u>Fair</u>	<u>Amortized</u>	<u>Fair</u>
	<u>Cost</u>	<u>Value</u>	<u>Cost</u>	<u>Value</u>
Within 1 year	\$ 675,017	\$ 675,274	\$ 674,100	\$ 670,763
Over 1 year through 5 years	2,847,003	2,829,408	109,777	111,854
Over 5 year through 10 years	927,986	969,870	-	-
Over 10 years	19,497,081	18,881,445	187,500	180,000
Mortgage-backed securities and collateral mortgage obligations	<u>64,606,427</u>	<u>65,673,217</u>	<u>_____</u>	<u>_____</u>
	<u>\$88,553,514</u>	<u>\$89,029,214</u>	<u>\$971,377</u>	<u>\$ 962,617</u>

# CHAMPLAIN BANK CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements

**December 31, 2010 and 2009**

For the years ended December 31, 2010 and 2009, proceeds from sales of securities available-for-sale amounted to \$6,884,061 and \$4,344,235, respectively. Gross realized gains amounted to \$85,101 and \$56,700 at December 31, 2010 and 2009, respectively. Gross realized losses amounted to \$29,750 and \$506,797 at December 31, 2010 and 2009, respectively.

There were no sales of securities held-to-maturity during 2010 and 2009.

Investments with continuous unrealized losses for a period of less than twelve months and twelve months or greater as of December 31, 2010 are as follows:

	<u>Less than 12 months</u>		<u>12 months or greater</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>
State and municipal	\$ 14,745,572	\$ 541,355	\$ 2,391,162	\$ 78,307	\$ 17,136,734	\$ 619,662
Corporate	-	-	781,129	146,093	781,129	146,093
Mortgage-backed securities	17,450,138	426,487	-	-	17,450,138	426,487
Collateral mortgage obligations	<u>1,282,803</u>	<u>1,689</u>	<u>203,192</u>	<u>354,025</u>	<u>1,485,995</u>	<u>355,714</u>
	<u>\$ 33,478,513</u>	<u>\$ 969,531</u>	<u>\$ 3,375,483</u>	<u>\$ 578,425</u>	<u>\$ 36,853,996</u>	<u>\$ 1,547,956</u>

Investments with continuous unrealized losses for a period of less than twelve months and twelve months or greater as of December 31, 2009 are as follows:

	<u>Less than 12 months</u>		<u>12 months or greater</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>
U.S. Government and government sponsored agencies	\$ 2,990,369	\$ 4,988	\$ -	\$ -	\$ 2,990,369	\$ 4,988
State and municipal	5,916,311	99,227	2,001,117	106,265	7,917,428	205,492
Corporate	-	-	711,387	213,473	711,387	213,473
Mortgage-backed securities	4,057,890	22,078	-	-	4,057,890	22,078
Collateral mortgage obligations	<u>289,741</u>	<u>6,008</u>	<u>2,256,769</u>	<u>352,593</u>	<u>2,546,510</u>	<u>358,601</u>
	<u>\$ 13,254,311</u>	<u>\$ 132,301</u>	<u>\$ 4,969,273</u>	<u>\$ 672,331</u>	<u>\$ 18,223,584</u>	<u>\$ 804,632</u>

# CHAMPLAIN BANK CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements

December 31, 2010 and 2009

Management evaluates securities for other-than-temporary impairment 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.

As of December 31, 2010, the Bank had seven securities with a fair value of \$3,375,535 and an unrealized loss of \$578,425 that had been in a continuous unrealized loss position for 12 months or more. As of December 31, 2009, the Bank had eight securities with a fair value of \$4,969,273 and an unrealized loss of \$672,331 that had been in a continuous unrealized loss position for 12 months or more.

Management believes the unrealized loss positions are primarily due to the changes in the interest rate environment relative to the time of purchase, and general market conditions and there is little risk of loss or default from the counterparties. Because the decline is not attributable to credit quality and the Bank has the ability and intent to hold the securities for the foreseeable future to allow for recovery. The exception to this is a private issued collateralized mortgage obligation bond. Management performed an internal analysis on the market value of this security and recognized a write-down of the security totaling \$171,886 and \$177,575 for 2010 and 2009, respectively, of which \$128,200 for 2010 and \$125,000 for 2009 was recorded in the consolidated statements of income.

#### 4. Loans

A summary of the balances of loans as of December 31 is as follows:

	<u>2010</u>	<u>2009</u>
Real estate mortgages	\$ 7,562,257	\$ 8,330,791
Commercial loans	76,274,778	79,402,771
Home equity loans	14,062,842	11,681,444
Personal loans	<u>7,077,646</u>	<u>9,012,022</u>
	104,977,523	108,427,028
Allowance for loan losses	(1,835,595)	(1,908,963)
Net deferred loan costs	<u>385,112</u>	<u>369,570</u>
Loans, net	<u>\$103,527,040</u>	<u>\$ 106,887,635</u>

**CHAMPLAIN BANK CORPORATION AND SUBSIDIARY**

**Notes to Consolidated Financial Statements**

**December 31, 2010 and 2009**

An analysis of the allowance for loan losses is as follows:

	<u>Years Ended December 31,</u>	
	<u>2010</u>	<u>2009</u>
Balance at beginning of year	\$ 1,908,963	\$ 1,780,111
Provision for loan losses	320,000	275,200
Loans charged off	(419,718)	(166,539)
Recoveries of loans previously charged off	<u>26,350</u>	<u>20,191</u>
Balance at end of year	<u>\$ 1,835,595</u>	<u>\$ 1,908,963</u>

The following table presents the allowance for loan losses and select loan information for the year ended December 31, 2010:

	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Residential Real Estate</u>	<u>Consumer</u>	<u>Unallocated</u>	<u>Total</u>
<b>Allowance for loan losses</b>						
Ending balance	\$ <u>229,153</u>	\$ <u>762,222</u>	\$ <u>97,313</u>	\$ <u>167,195</u>	\$ <u>579,712</u>	\$ <u>1,835,595</u>
Individually evaluated for impairment	\$ <u>-</u>	\$ <u>23,633</u>	\$ <u>-</u>	\$ <u>-</u>	\$ <u>-</u>	\$ <u>23,633</u>
Collectively evaluated for impairment	\$ <u>229,153</u>	\$ <u>738,589</u>	\$ <u>97,313</u>	\$ <u>167,195</u>	\$ <u>579,712</u>	\$ <u>1,811,962</u>
<b>Loans</b>						
Ending balance	\$ <u>19,971,622</u>	\$ <u>56,303,156</u>	\$ <u>21,625,099</u>	\$ <u>7,077,646</u>		\$ <u>104,977,523</u>
Individually evaluated for impairment	\$ <u>99,749</u>	\$ <u>774,573</u>	\$ <u>37,860</u>	\$ <u>-</u>		\$ <u>912,182</u>
Collectively evaluated for impairment	\$ <u>19,871,874</u>	\$ <u>55,528,583</u>	\$ <u>21,587,239</u>	\$ <u>7,077,646</u>		\$ <u>104,065,341</u>

Management judgment of the likelihood of a loss is demonstrated by the internal risk rating assigned to each loan in the commercial, residential mortgage and consumer portfolios.

The commercial, commercial real estate, residential mortgage and home equity loans and lines are monitored for quality and the likelihood of loss. Based on current information surrounding the facts and circumstances of the loan, an internal credit rating is assigned. Credit ratings 1-3W are deemed to be a performing loan with no significant likelihood of loss. The ratings are further measured as follows: 4 – special mention, 5 – substandard, 6 – doubtful and 7 – loss. Each of these ratings is supported by the facts and circumstances surrounding the loan that would cause a higher probability of some loss and thus, as the rating progresses up the scale, a higher reserve for loan loss is allocated to the particular group mentioned.

# CHAMPLAIN BANK CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements

December 31, 2010 and 2009

Loans rated 1 - Loans in this category are secured by cash or cash equivalent securities held by the Bank. In the event of default, the instrument would be liquidated to satisfy any unpaid balance.

Loans rated 2 - Loans in this category include borrowers of unquestioned credit standing and a consistently strong financial condition as evidenced by earnings, liquidity, leverage and cash flow.

Loans rated 3 - These loans include borrowers that have most of the characteristics of a loan rated 2, but the financial condition, management, or industry is not quite as strong.

Loans rated 3W - These loans are considered "watch list." While these loans are creditworthy, they exhibit some characteristics which require special attention by the loan officer. This is the lowest permissible rating for a new loan. Loans rated as 3W are closely monitored as any deterioration may be cause for prompt re-rating to 4 or lower. Principal areas of concern may be management problems, industry stress, financial deterioration, operating losses, inadequate cash flow, highly cyclical industries, or any other area that would negatively affect the borrower's ability to repay the obligation in full on a timely basis.

Loans rated 4 - Loans in this category are considered "special mention." These loans are considered protected but may have potential weaknesses, which may weaken the asset or inadequately protect the Bank's credit position at some future date.

Loans rated 5 - Loans in this category are considered "substandard." These loans might be inadequately protected by the current net worth and paying capacity of the borrower or of the collateral pledged, if any. Assets so classified often have well-defined weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Loans rated 6 - Loans in this category are considered "doubtful." Loans classified as doubtful have all the weaknesses inherent in one classified as substandard with the added characteristic that the weaknesses may make collection in full improbable on the basis of currently existing facts, conditions and values. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors, which may strengthen the asset; its rating as 7 is deferred until its more exact status may be determined. Pending factors include proposed merger, acquisition, or liquidation procedures, capital injection, perfecting liens on additional collateral and refinancing plans.

Loans rated 7 - Loans in this category are considered "loss" or uncollectible. For these loans it is not practical or desirable to defer writing off the loan even though partial recovery may be affected in the future.

**CHAMPLAIN BANK CORPORATION AND SUBSIDIARY**

**Notes to Consolidated Financial Statements**

**December 31, 2010 and 2009**

Consumer loans are credit rated as either a pass or substandard. A loan is typically rated substandard when it becomes 90 days past due or in circumstances such as bankruptcy or excessive tax liens. Higher reserves are allocated to substandard consumer loans as there would be a higher probability of loss. Consumer loans that reach 120 days delinquent are charged off.

The following tables summarize credit risk indicators by portfolio as of December 31, 2010:

**Commercial Credit Risk Exposure  
Credit Risk Profile by Internally Assigned Grade**

	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Residential Real Estate</u>
Pass	\$ 19,561,134	\$ 54,446,381	\$ 21,594,134
Special mention	310,739	775,282	-
Substandard	99,749	1,081,492	37,860
Doubtful	-	-	-
Loss	-	-	-
Total	<u>\$ 19,971,622</u>	<u>\$ 56,303,155</u>	<u>\$ 21,631,994</u>

**Consumer Credit Exposure  
Credit Risk Profile by Internally Assigned Grade**

Pass	\$ 7,041,806
Substandard	<u>35,840</u>
Total	<u>\$ 7,077,646</u>

**CHAMPLAIN BANK CORPORATION AND SUBSIDIARY**

**Notes to Consolidated Financial Statements**

**December 31, 2010 and 2009**

The following table presents an aging analysis of past due loans as of December 31, 2010:

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Loans on Nonaccrual
Commercial	\$ -	\$ -	\$ 10,000	\$ 10,000	\$ 19,961,622	\$ 19,971,622	\$ 99,749
Commercial real estate	387,953	-	90,194	478,147	55,825,009	56,303,156	774,573
Residential real estate	48,112	-	37,860	85,972	21,539,127	21,625,099	37,860
Consumer	<u>174,789</u>	<u>125,128</u>	<u>23,289</u>	<u>323,206</u>	<u>6,754,440</u>	<u>7,077,646</u>	<u>-</u>
Total	<u>\$ 610,854</u>	<u>\$ 125,128</u>	<u>\$ 161,343</u>	<u>\$ 897,325</u>	<u>\$ 104,080,198</u>	<u>\$ 104,977,523</u>	<u>\$ 912,182</u>

Nonaccrual loans amounted to \$1,555,462 at December 31, 2009. There were no loans greater than ninety days past due and still accruing interest at December 31, 2010 or 2009.

The following table presents a summary of information pertaining to impaired loans by loan category as of December 31, 2010:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Interest Income Recognized
With no related allowance recorded:				
Commercial	\$ 99,749	\$ 99,749	\$ -	\$ 7,585
Commercial real estate	678,929	678,929	-	9,450
Residential real estate	37,860	37,860	-	222
Consumer	-	-	-	-
With an allowance recorded:				
Commercial	\$ -	\$ -	\$ -	\$ -
Commercial real estate	72,011	95,644	23,633	5,973
Residential real estate	-	-	-	-
Consumer	-	-	-	-
Total:				
Commercial	\$ 99,749	\$ 99,749	\$ -	\$ 7,585
Commercial real estate	750,940	774,573	23,633	15,423
Residential real estate	37,860	37,860	-	222
Consumer	-	-	-	-

**CHAMPLAIN BANK CORPORATION AND SUBSIDIARY**

**Notes to Consolidated Financial Statements**

**December 31, 2010 and 2009**

The following is a summary of information pertaining to impaired loans:

	<u>2010</u>	<u>2009</u>
Impaired loans without a valuation allowance	\$ 816,538	\$ 1,396,614
Impaired loans with a valuation allowance	<u>95,644</u>	<u>158,848</u>
Total impaired loans	\$ <u>912,182</u>	\$ <u>1,555,462</u>
Valuation allowance related to impaired loans	\$ <u>23,633</u>	\$ <u>51,307</u>
	<u>Years Ended December 31,</u>	
	<u>2010</u>	<u>2009</u>
Average investment in impaired loans	\$ <u>1,133,383</u>	\$ <u>1,304,733</u>
Interest income recognized on impaired loans, all on cash basis	\$ <u>23,230</u>	\$ <u>55,922</u>

No additional funds are committed to be advanced in connection with impaired loans.

**5. Premises and Equipment**

A summary of the cost and accumulated depreciation of premises and equipment follows:

	<u>2010</u>	<u>2009</u>
Land and improvements	\$ 133,278	\$ 133,278
Buildings and improvements	3,820,185	3,732,812
Furniture and equipment	4,465,084	5,119,367
Construction in progress	<u>471,372</u>	<u>508,711</u>
	8,889,919	9,494,168
Accumulated depreciation	<u>(5,817,627)</u>	<u>(6,419,651)</u>
	\$ <u>3,072,292</u>	\$ <u>3,074,517</u>

# CHAMPLAIN BANK CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements

December 31, 2010 and 2009

Pursuant to the terms of noncancelable lease agreements in effect at December 31, 2010, pertaining to office space for two Plattsburgh branches, future minimum rent commitments under various operating leases are as follows:

2011	\$ 82,864
2012	82,864
2013	78,358
2014	28,800
2015	28,800
2016 and beyond	<u>38,400</u>
	\$ <u>340,086</u>

The leases contain options to renew. The cost of such rentals is not included above. Total rent expense for the years ended December 31, 2010 and 2009, amounted to \$106,346 and \$115,175, respectively.

### 6. Deposits

The aggregate amount of time deposits in denominations of \$100,000 or more at December 31, 2010 and 2009, was \$19,776,231 and \$23,026,139, respectively.

At December 31, 2010, the scheduled maturities of time deposits are as follows:

2011	\$ 38,059,871
2012	6,306,704
2013	1,913,151
2014	495,502
Thereafter	<u>822,557</u>
	\$ <u>47,597,785</u>

### 7. Advances from Federal Home Loan Bank

Pursuant to collateral agreements with the Federal Home Loan Bank of New York (FHLB), advances are collateralized by all stock in the FHLB, qualifying first mortgages and securities available-for-sale.

At December 31, 2010, the interest rates on fixed-rate advances ranged from 0.40% to 4.03%. At December 31, 2009, the interest rate on fixed-rate advances ranged from 2.60% to 4.41%. The Bank had no floating rate advances at December 31, 2010 and 2009.

# CHAMPLAIN BANK CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements

December 31, 2010 and 2009

The contractual maturities of advances at December 31, 2010, are as follows:

2011	\$ 2,500,000
2012	5,000,000
2013	<u>5,000,000</u>
Total	<u>\$ 12,500,000</u>

The contractual maturities of advances at December 31, 2009, are as follows:

2010	\$ 5,000,000
2012	5,000,000
2013	<u>5,000,000</u>
Total	<u>\$ 15,000,000</u>

At December 31, 2010, the Bank's total FHLB borrowing capacity was \$21,952,902, of which \$9,452,902 was unused and available for additional borrowings.

The Bank's total borrowing capacity from the Federal Reserve Bank was \$49,595,504 at December 31, 2010. The Bank also had \$5,000,000 available under long-term lines-of-credit at December 31, 2010. There were no amounts outstanding under these lines-of-credit at December 31, 2010 or 2009.

### 8. Income Taxes

Allocation of federal and state income tax expense between current and deferred portions is as follows:

	<u>2010</u>	<u>2009</u>
Current tax (benefit) expense		
Federal	\$ 53,702	\$ (516,033)
State	<u>135,529</u>	<u>94,193</u>
	<u>189,231</u>	<u>(421,840)</u>
Deferred federal tax expense	<u>203,529</u>	<u>568,700</u>
	<u>\$ 392,760</u>	<u>\$ 146,860</u>

# CHAMPLAIN BANK CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements

December 31, 2010 and 2009

The income tax provision differs from the expense that would result from applying federal statutory rates to income before income taxes, as follows:

	<u>2010</u>	<u>2009</u>
Computed tax expense	\$ 617,122	\$ 376,831
Increase (reduction) in income taxes resulting from:		
Tax-exempt interest	(290,942)	(277,299)
State taxes, net of federal benefit	89,383	62,167
Income from life insurance	(55,329)	(54,789)
Other	<u>32,526</u>	<u>39,950</u>
	<u>\$ 392,760</u>	<u>\$ 146,860</u>

The components of the net deferred tax asset, included in other assets, are as follows:

	<u>2010</u>	<u>2009</u>
Deferred tax assets		
Allowance for loan losses	\$ 726,201	\$ 789,480
Deferred compensation plans	1,347,371	1,272,015
Other	<u>58,176</u>	<u>-</u>
	<u>2,131,748</u>	<u>2,061,495</u>
Deferred tax liabilities		
Prepaid pension and other postretirement benefits	608,039	298,510
Depreciation	269,714	260,559
Other	-	47,843
Net unrealized gain on securities available-for-sale	<u>190,280</u>	<u>491,160</u>
	<u>1,068,033</u>	<u>1,098,072</u>
	1,063,715	963,423
Valuation allowance	<u>(21,708)</u>	<u>(21,708)</u>
Net deferred income tax asset	<u>\$ 1,042,007</u>	<u>\$ 941,715</u>

# CHAMPLAIN BANK CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements

December 31, 2010 and 2009

The valuation allowance, as established by management, takes into consideration the historical level of taxable income in prior years as well as the time period in which the items giving rise to the deferred tax assets will be recognized.

### 9. Financial Instruments with Off-Balance-Sheet Risk

The Company is a party to credit related financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and letters-of-credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets.

The Company's exposure to credit loss is represented by the contractual amount of these commitments. The Company follows the same credit policies in making commitments as it does for on-balance-sheet instruments.

At December 31, 2010 and 2009, the following financial instruments were outstanding whose contract amounts represent credit risk:

	<u>Contract Amount</u>	
	<u>2010</u>	<u>2009</u>
Commitments to grant loans	\$ 6,387,226	\$ 4,214,000
Unfunded commitments under lines-of-credit	18,617,360	18,094,534
Commercial and standby letters-of-credit	283,225	345,000

Commitments to extend credit 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. The commitments for equity lines-of-credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Company, is based on management's credit evaluation of the customer.

Unfunded commitments under commercial lines-of-credit, revolving credit lines and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These lines-of-credit are uncollateralized and usually do not contain a specified maturity date and may not be drawn upon to the total extent to which the Company is committed.

# CHAMPLAIN BANK CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements

December 31, 2010 and 2009

Standby letters-of-credit are conditional lending commitments issued by the Company to guarantee the performance of a customer to a third party. Those letters-of-credit are primarily issued to support public and private borrowing arrangements. Essentially all letters-of-credit issued have expiration dates within one year. The credit risk involved in issuing letters-of-credit is essentially the same as that involved in extending loan facilities to customers.

To reduce credit risk related to the use of credit-related financial instruments, the Company might deem it necessary to obtain collateral. The amount and nature of the collateral obtained is based on the Company's credit evaluation of the customer. Collateral held varies, but may include cash, securities, accounts receivable, inventory, property, plant and equipment, and real estate.

### **10. Minimum Regulatory Capital Requirements**

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

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the following table) 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, 2010 and 2009, that the Company and the Bank met all capital adequacy requirements to which they are subject.

**CHAMPLAIN BANK CORPORATION AND SUBSIDIARY**

**Notes to Consolidated Financial Statements**

**December 31, 2010 and 2009**

As of December 31, 2010, the most recent notification from the Office of the Comptroller of the Currency (OCC) categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since the notification that management believes have changed the Bank's category. The Company's and the Bank's actual capital amounts and ratios as of December 31, 2010 and 2009, are also presented in the table.

	<u>Actual</u>		<u>Minimum Capital Requirement</u>		<u>Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
<b><u>December 31, 2010</u></b>						
Total Capital to Risk Weighted Assets						
Consolidated	\$18,950,011	14.6%	\$10,382,953	8.0%	\$ N/A	N/A%
Bank	18,948,641	14.6	10,382,953	8.0	12,999,754	10.0
Total Capital to Risk Weighted Assets						
Consolidated	17,325,042	13.35	5,191,477	4.0	N/A	N/A
Bank	17,323,671	13.35	5,191,477	4.0	7,799,852	6.0
Total Capital to Risk Weighted Assets						
Consolidated	17,325,042	8.18	8,466,739	4.0	N/A	N/A
Bank	17,323,671	8.18	8,466,739	4.0	10,583,424	5.0
<b><u>December 31, 2009</u></b>						
Total Capital to Risk Weighted Assets						
Consolidated	\$17,848,022	13.67%	\$10,441,456	8.0%	N/A	N/A
Bank	17,843,059	13.67	10,441,456	8.0	\$ 13,051,819	10.0%
Total Capital to Risk Weighted Assets						
Consolidated	16,216,545	12.42	5,220,728	4.0	N/A	N/A
Bank	16,211,582	12.42	5,220,728	4.0	7,831,092	6.0
Total Capital to Risk Weighted Assets						
Consolidated	16,216,545	8.07	8,036,027	4.0	N/A	N/A
Bank	16,211,582	8.07	8,036,027	4.0	10,045,034	5.00

# CHAMPLAIN BANK CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements

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### 11. Employee Benefit Plans

#### 401(k) Plan

The Company has a 401(k) plan whereby all employees are eligible to participate in the plan at the first enrollment date after hire. Participants may contribute up to the maximum amount allowed by federal tax laws. The Company made matching contributions equal to 4% of compensation in 2010 and 2009. The Company may also make a profit-sharing contribution to the plan. There were contributions of 1% of each eligible employee's compensation in 2010 and 2009. For the years ended December 31, 2010 and 2009, expense attributable to the plan amounted to \$131,345 and \$128,665, respectively.

#### Supplemental Retirement Plan and Deferred Compensation Plan

The Company sponsors an unfunded, non-qualified supplemental retirement plan for certain officers. The agreement provides supplemental retirement payments payable over 15-20 years upon retirement or death. The costs for this plan are recognized over the service periods of the participating officers. Life insurance policies were acquired to serve as the primary funding source. The cash value of these policies was \$992,001 and \$898,359 at December 31, 2010 and 2009, respectively.

The expenses of this supplemental plan were \$195,732 and \$149,700 in 2010 and 2009, respectively. As of December 31, 2010 and 2009, the accrued liability of this plan was \$1,307,666 and \$1,179,434, respectively.

The Company also owns split-dollar life insurance policies for certain key employees. The cash value of these policies, net of accumulated life insurance obligations, was \$2,956,218 and \$2,822,691 at December 31, 2010 and 2009, respectively.

The Company sponsors an unfunded, non-qualified deferred compensation plan for the Company's board of directors. The costs for this plan are recognized over the service periods of the participating board members.

The expenses of this plan, including board fees and interest, were \$163,066 and \$164,061 in 2010 and 2009, respectively. Payments to board members were \$35,279 and \$18,283 in 2010 and 2009, respectively. As of December 31, 2010 and 2009, the accrued liability of this plan was \$1,812,032 and \$1,684,245, respectively.

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**Defined Benefit Pension Plan**

The Company is a member of the New York State Bankers Retirement System and offers a non-contributory defined benefit pension plan to substantially all full-time employees and part-time employees as required by law. Benefit payments to retired employees are based upon their length of service and a percentage of qualifying compensation during the final years of employment. Contributions are intended to provide not only for benefits attributed to service to date, but also for those expected to be earned in the future. Assets of the plan are primarily invested in equity and debt securities. The costs for this plan are recognized over the service periods of the participating employees.

On January 1, 2009, the Company changed the measurement date of the defined benefit pension plan from October 1 to December 31 and adjusted accumulated other comprehensive loss by \$211,790 and retained earnings by \$16,885.

The following table sets forth the plan's funded status and amounts recognized in the Company's consolidated balance sheets as of December 31:

	<u>2010</u>	<u>2009</u>
Benefit obligation at December 31	\$ 7,912,821	\$ 7,231,939
Fair value of plan assets at December 31	<u>10,102,965</u>	<u>8,450,812</u>
Funded status	\$ <u>2,190,144</u>	\$ <u>1,218,873</u>
Accumulated benefit obligation	\$ <u>6,871,899</u>	\$ <u>6,215,941</u>
Prepaid pension cost included in other assets in the consolidated balance sheet	\$ <u>2,190,144</u>	\$ <u>1,218,873</u>
Weighted average assumptions used to determine benefit obligation		
Discount rate	<b>5.38%</b>	5.89%
Rate of compensation increase	<b>3.50%</b>	3.50%
Weighted average assumptions used to determine net benefit cost		
Discount rate	<b>5.89%</b>	6.03%
Expected return on plan assets	<b>7.50%</b>	7.50%
Rate of compensation increase	<b>3.50%</b>	3.50%

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The following table discloses additional information regarding the pension plan for the years ended December 31:

	<u>2010</u>	<u>2009</u>
Employer contributions	<b>\$1,200,000</b>	\$2,000,000
Benefits paid	<b>380,795</b>	356,053
Benefit cost	<b>304,574</b>	573,202

The Company expects to make a contribution to the plan in 2011; however, the amount has not been determined.

Future benefit payments are expected to be paid as follows:

Years ending December 31:

2011	\$ 301,602
2012	307,745
2013	314,746
2014	326,444
2015	347,244
Years 2016 – 2020	2,360,218

The Company's pension plan asset allocations by asset category are as follows:

<u>Asset Category</u>	<u>Plan Assets at December 31</u>	
	<u>2010</u>	2009
Equity securities	<b>48%</b>	48%
Debt securities	<b>41%</b>	40%
Other	<b><u>11%</u></b>	<u>12%</u>
Total	<b><u>100%</u></b>	<u>100%</u>

The New York State Bankers Retirement System (the "System") was established in 1938 to provide for the payment of benefits to employees of participating banks. The System is overseen by a Board of Trustees who meet quarterly and set the investment policy guidelines.

The System utilizes two investment management firms each investing approximately 50% of the total portfolio. The System's investment objective is to exceed the investment benchmarks in each asset category. Each firm operates under a separate written investment policy approved by the

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Trustees and designed to achieve an allocation approximating 60% invested in equity securities and 40% invested in debt securities.

Each Firm reports at least quarterly to the Investment Committee of the System and semi-annually to the Board of the System.

The expected long-term rate-of-return on plan assets reflects long-term earnings expectations on existing plan assets and those contributions expected to be received during the current plan year. In estimating that rate, appropriate consideration was given to historical returns earned by plan assets in the fund and the rates of return expected to be available for reinvestment. Average rates of return over the past one-, three-, five-, and ten-year periods were determined and, subsequently, adjusted to reflect current capital market assumptions and changes in investment allocations.

### Defined Benefit Postretirement Plan

In addition to the Company's non-contributory defined benefit pension plan, the Company provides a defined benefit postretirement plan which provides medical benefits and life insurance benefits to employees who were hired before January 1, 2005, and have attained 55 years of age with 10 years of service. The postretirement health care portion of the plan is contributory, with participants' contributions adjusted annually, and contains other cost-sharing features such as deductibles and coinsurance. While the amount of a participant's contribution varies depending upon age and service, the Company has set a maximum dollar amount it will pay for medical benefits regardless of age or service. The funding policy of the plan is to pay claims and/or insurance premiums as they come due. The costs for this plan are recognized over the service periods of the participating employees.

The following table presents the amounts recognized in the Company's consolidated balance sheets as of December 31:

	<u>2010</u>	<u>2009</u>
Benefit obligation at December 31	\$ 883,463	\$ 739,867
Fair value of plan assets at December 31	<u>                    </u>	<u>                    </u>
Funded status	\$ <u>(883,463)</u>	\$ <u>(739,867)</u>
Accrued postretirement costs included in the consolidated balance sheet	\$ <u>(883,463)</u>	\$ <u>(739,867)</u>
Weighted average assumption used to determine benefit obligation		
Discount rate	5.38%	5.89%
Weighted average assumption used to determine net benefit cost		
Discount rate	5.89%	6.03%

# CHAMPLAIN BANK CORPORATION AND SUBSIDIARY

## Notes to Consolidated Financial Statements

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The following table discloses additional information regarding the postretirement plan for the years ended December 31:

	<u>2010</u>	<u>2009</u>
Employer contributions	\$ 27,073	\$ 30,376
Benefits paid	27,073	30,376
Benefit cost	87,602	82,168

The Company expects to make a contribution to the plan in 2010; however, the amount has not been determined.

Future benefit payments are expected to be paid as follows:

Years ending December 31:

2011	\$ 28,119
2012	29,073
2013	30,554
2014	32,395
2015	34,704
Years 2016 – 2020	233,190

The health care cost trend rate assumption does not have a significant effect on the reported amounts as a result of the Company's cap on the maximum contribution it will pay.

In December 2003, the President signed the federal Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act) into law. The Act includes the following two new features to Medicare (Medicare Part D) that could affect the measurement of the accumulated postretirement benefit obligation (APBO) and net periodic postretirement benefit cost for the Plan:

- A subsidy to plan sponsors that is based on 28% of an individual beneficiary's annual prescription drug costs between \$250 and \$5,000.
- The opportunity for a retiree to obtain a prescription drug benefit under Medicare.

During 2004, FASB Staff issued guidance on *Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003* (the Act). The guidance addresses employers' accounting for the effects of the Act and was effective for the Company in 2005. The accounting for the Act depends on the Company's assessment as to whether the prescription drug benefits available under its plan are actuarially equivalent to Medicare Part D,

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among other factors. Therefore, the effects of the Act on the accumulated postretirement benefit obligation or benefit cost are not reflected in the financial statements or accompanying notes.

Amounts not yet reflected in net periodic benefit cost and included in accumulated other comprehensive loss for the defined benefit pension and postretirement plans at December 31, are as follows:

	<u>2010</u>	<u>2009</u>
Unamortized prior service cost	\$ 30,645	\$ 34,498
Unamortized net actuarial loss	2,557,058	2,530,462
Unrecognized transition obligation	<u>62,087</u>	<u>77,608</u>
	2,649,790	2,642,568
Deferred tax benefit at 40%	<u>1,059,916</u>	<u>1,057,113</u>
Net unrecognized loss on pension and other postretirement benefits included in accumulated other comprehensive loss	<u>\$ 1,589,874</u>	<u>\$ 1,585,455</u>

The following amounts were recognized in other comprehensive income (loss) in 2010 and 2009:

	<u>2010</u>	<u>2009</u>
Net actuarial (loss) gain	\$ (156,697)	\$ 1,032,750
Reclassifications to net periodic benefit cost		
Amortization of transition obligation	15,521	15,521
Amortization of net unrecognized actuarial loss	130,101	223,900
Amortization of prior service cost	<u>3,853</u>	<u>3,853</u>
	(7,222)	1,276,024
Tax effect	<u>(2,803)</u>	<u>510,413</u>
	<u>\$ (4,419)</u>	<u>\$ 765,611</u>

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The following amounts are expected to be reclassified from accumulated other comprehensive loss and recognized in net periodic benefit cost in 2011:

	<u>Pension</u>	<u>Postretirement</u>
Transition asset	\$ -	\$ 15,521
Unamortized prior service cost (credit)	10	3,843
Unamortized net actuarial loss	<u>117,560</u>	<u>-</u>
	<u>\$ 117,570</u>	<u>\$ 19,364</u>

### 12. Other Noninterest Expenses

The components of other noninterest expenses, which are in excess of 1% of total revenues (total interest and dividend income and other income) and not shown separately in the consolidated statements of income, are as follows for the years ended December 31:

	<u>2010</u>	<u>2009</u>
FDIC fees	\$ 258,625	\$ 354,345
Audit fees	176,800	152,300
Software maintenance fees	225,819	212,169
Other consultants	139,108	95,972
Debit card processing fees	129,612	107,326
Net expenses from other real estate owned	125,488	-
Director fees	<u>128,856</u>	<u>121,700</u>
	<u>\$1,184,308</u>	<u>\$1,043,812</u>

### 13. Related Party Transactions

In the ordinary course of business, the Bank has granted loans to principal officers and directors and their affiliates amounting to \$2,012,051 at December 31, 2010 and \$1,811,872 at December 31, 2009. During the years ended December 31, 2010 and 2009, total principal payments were \$833,424 and \$227,024, respectively. During 2010, \$1,033,603 was added to principal. There were no principal additions in 2009.

Deposits from related parties held by the Bank at December 31, 2010 and 2009, amounted to \$2,038,934 and \$2,053,799, respectively.

# CHAMPLAIN BANK CORPORATION AND SUBSIDIARY

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### **14. Restrictions On Dividends**

Income earned by the Bank is the primary source of funds available to the Company for payment of dividends to its stockholders and for other working capital needs. Applicable federal and state statutes, regulations, and guidelines impose restrictions on the amount of dividends that may be declared by the Bank. Under these restrictions, the dividends declared by the Bank to the Company in 2011 may not exceed the aggregate of the Bank's net profits in 2011 combined with its retained net profits from the two preceding years of approximately \$1,828,800.

In addition, dividends paid by the Bank to the Company would be prohibited if the effect thereof would cause the Bank's capital to be reduced below applicable minimum capital requirements.

### **15. Legal Contingencies**

Various legal claims also arise from time-to-time in the normal course of business which, in the opinion of management, will have no material effect on the Company's consolidated financial statements.

### **16. Fair Value Measurements**

FASB ASC 820, *Fair Value Measurements and Disclosures*, defines fair value, establishes a framework for measuring fair value in accordance with U.S. generally accepted accounting principles, and expands disclosures about fair value measurements.

ASC 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. FASB ASC 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

**Level 1:** Quoted prices (unadjusted) or identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

**Level 2:** Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.

**Level 3:** Significant unobservable inputs that reflect an organization's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

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Assets and liabilities measured at fair value on a recurring basis are summarized below.

		<u>Fair Value Measurements Using</u>		
		Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	<u>Total</u>			
<b><u>December 31, 2010</u></b>				
Assets (market approach):				
Securities available-for-sale				
U.S. Government and government				
sponsored enterprises	\$ 552,825	\$ -	\$ 552,825	\$ -
State and municipal	22,022,043	-	22,022,043	-
Corporate	781,129	-	781,129	-
Mortgage-backed securities	57,303,873	-	57,303,873	-
Collateral mortgage obligations	8,369,344	-	8,369,344	-
Assets held by defined				
benefit pension plan				
Equities	4,873,388	4,873,388	-	-
Debt securities	4,094,833	-	4,094,833	-
Other	1,134,744	21,867	1,112,877	-
 <u>December 31, 2009</u>				
Assets (market approach):				
Securities available-for-sale				
U.S. Government and government				
sponsored enterprises	\$ 9,958,156	\$ -	\$ 9,958,156	\$ -
State and municipal	20,874,886	-	20,874,886	-
Corporate	711,387	-	711,387	-
Mortgage-backed securities	39,334,767	-	39,334,767	-
Collateral mortgage obligations	9,107,277	-	9,107,277	-
Assets held by defined				
benefit pension plan				
Equities	4,056,390	4,056,390	-	-
Debt securities	3,380,325	-	3,380,325	-
Other	1,014,097	-	1,014,097	-

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Assets and liabilities measured at fair value on a nonrecurring basis are summarized below.

		<u>Fair Value Measurements Using</u>		
		Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	<u>Total</u>			
<b><u>December 31, 2010</u></b>				
Assets (market approach):				
Impaired loans	\$ 72,011	\$ -	\$ 72,011	\$ -
 <u>December 31, 2009</u>				
Assets (market approach):				
Impaired loans	\$ 107,541	\$ -	\$ 107,541	\$ -

Certain impaired loans were written down to their fair value of \$72,011 and \$107,541 in 2010 and 2009, respectively.

Fair value estimates are made at a specific point in time, based on relevant market information and information about specific financial instruments. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no active observable market exists for a portion of the Company's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

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

*Cash and cash equivalents:* The carrying amounts of cash and short-term instruments approximate fair values.

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*Securities:* The fair values of investment securities, other than FHLB and FRB stock, are based on quoted market prices on nationally recognized securities exchanges, where available, or matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for the specific securities, but rather relying on the securities' relationship to other benchmark quoted securities. The fair value of FHLB and FRB stock is equal to cost, since there is no secondary market for these instruments.

*Loans receivable:* For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. The fair value of impaired loans is primarily based upon appraisals by third-party appraisers and brokers' opinions by third-party brokers. The appraisals and opinions are based upon comparable prices for similar assets in active markets for residential real estate loans, and less active markets for commercial loans.

*Deposit liabilities:* The fair values for demand deposits (e.g., interest and non-interest checking, passbook savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). The carrying amounts of variable-rate, fixed-term money market accounts and certificates of deposit approximate their fair values at the reporting date. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregate expected monthly maturities on the certificates.

*Advances from Federal Home Loan Bank:* The fair values of these borrowings are estimated using discounted cash flow analyses based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

*Accrued interest:* The carrying amounts of accrued interest approximate fair value.

*Off-balance-sheet instruments:* The Company's off-balance-sheet instruments consist of loan commitments. Fair values for loan commitments have not been presented as the future revenue derived from such financial instruments is not significant.

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The estimated fair values, and related carrying or notional amounts, of the Company's financial instruments at December 31 are as follows:

	2010		2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets				
Cash and cash equivalents	\$ 4,441,376	4,441,376	\$ 4,066,359	\$ 4,066,359
Federal funds sold	74,285	74,285	138,502	138,502
Securities available-for-sale	89,029,214	89,029,214	79,986,473	79,986,473
Securities held-to-maturity	971,377	962,617	453,580	488,265
Federal Home Loan Bank and Federal Reserve Bank stock	862,100	862,100	1,033,300	1,033,300
Loans, net	103,527,070	106,414,011	106,887,635	107,611,264
Accrued interest receivable	794,152	794,152	851,565	851,565
Financial liabilities				
Deposits	178,267,232	171,162,663	169,349,179	152,026,451
Advances from Federal Home Loan Bank	12,500,000	13,218,000	15,000,000	15,711,300
Accrued interest payable	104,399	104,399	153,704	153,704

**17. Subsequent Events**

Subsequent events per FASB ASC 855-10 represent events or transactions occurring after the balance sheet date, but before the financial statements are available to be issued.

Specifically, there are two types of subsequent events:

- Those comprising events or transactions providing additional evidence about conditions that existed at the balance sheet date, including estimates inherent in the financial statement preparation process (referred to as recognized subsequent events).
- Those comprising events that provide evidence about conditions not existing at the balance sheet date, but, rather, that arose after such date (referred to as non-recognized subsequent events).

Subsequent events have been evaluated through March 28, 2011 the date the December 31, 2010 financial statements were available to be issued.