

Our Shareholders of Today and Tomorrow...



Annual Report 2008

LNB Lyons Bancorp Inc.
It's all about *people*. LNB & you.

PROFILE

Lyons Bancorp, Inc. is a bank holding company headquartered in Lyons, New York, with assets of \$411 million at December 31, 2008. Lyons Bancorp, Inc. has one banking subsidiary, The Lyons National Bank.

The Lyons National Bank is a community bank with offices in Clyde, Lyons, Macedon, Newark, Ontario and Wolcott in Wayne County, Jordan in Onondaga County, Geneva in Ontario County and Penn Yan in Yates County. Subsidiaries of The Lyons National Bank are Lyons Realty Associates Corp. and LNB Life Agency, Inc.

STOCK SYMBOL

LYBC

ANNUAL MEETING

The annual meeting of the stockholders will take place at 4:30 p.m. on May 20, 2009 at the historic Ohmann Theatre in Lyons, New York.

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ON THE COVER

LNB's youngest shareholder, Joshua Person – eight months old, with parents Brad and Debbie Person. Phil and Mary Paliotti. Phil and Mary represent the many long-time customers of Lyons National Bank and shareholders of Lyons Bancorp. Phil's father, Philip, a local businessman and visionary, believed strongly in supporting his local hometown bank. The extended Paliotti family has been shareholders since the 1920s.

President's Message

In keeping with the theme of change that has swept over America, we modified the format of this year's annual report by separating the financial schedules from my report and those of the management team. The new format will allow us to expand the report's value as marketing material that our calling officers can use year-round. It also reduced our production cost. I'm interested in hearing your thoughts, pro and con, on the change.

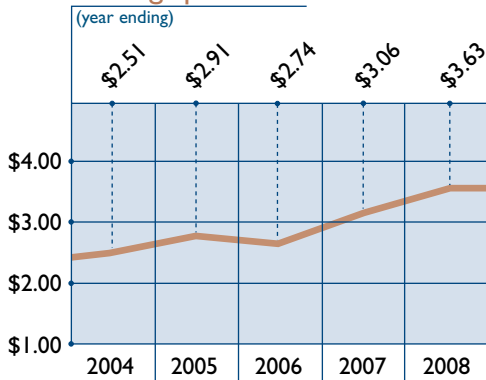
2008 RESULTS

I'll touch on a few financial points, but Diana Johnson, our Executive Vice President and Chief Financial Officer, has a complete recap of our 2008 financial results in her report which follows.



Robert A. Schick
President &
Chief Executive Officer
Lyons Bancorp, Inc. and
The Lyons National Bank

Earnings per Share

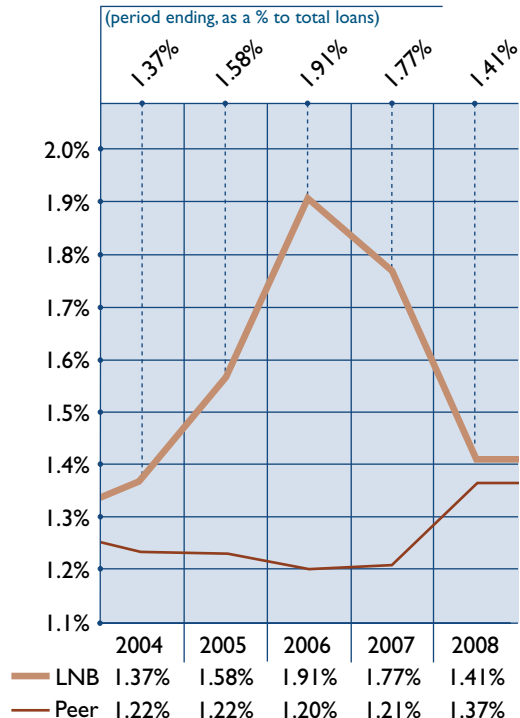


Our 2008 operating results were again record-breaking. With the settlement of a Bank Owned Life Insurance Policy, we made \$3.1 million last year, an increase of almost 18% over the \$2.6 million recorded in 2007. Without the settlement, earnings still increased 8%. The \$3.1 million equates to \$3.63 earnings per share compared to \$3.06 earnings per share in 2007. More rewarding than the level of our earnings was the fact that we accomplished what we did in the most troubling financial times since the Great Depression, and that we generated these earnings by following long-standing safe and sound banking practices. Not too many years ago, financial kingpins of the large banking institutions were writing the epitaph of community banking. Their reasoning: banks needed to become financial supermarkets in order to survive. Size, diversification and creativity were the recipe for future success; small and simple

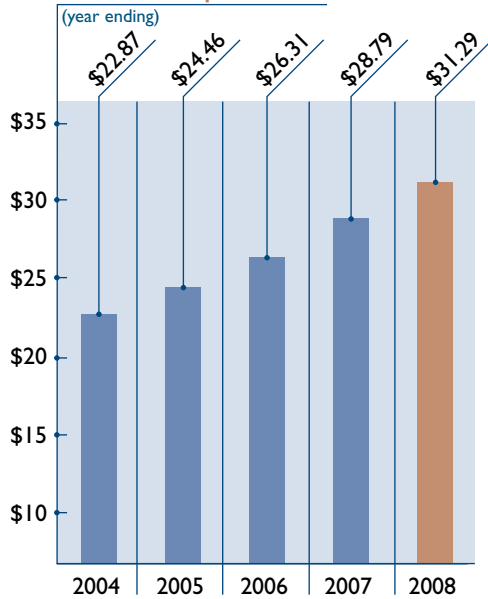
was considered passé — doomed to extinction. A part of me wishes some of those "experts" were still around to debate the issue.

Even though we did not participate in the risky sub-prime mortgage lending business, and our level of non-performing loans is only about half that of our peers (1.09% of our total loans versus 2.04% for our peer group), we felt it was prudent to continue our aggressive approach towards funding our Allowance for Loan Losses. In 2008, we added \$405,000 to our Allowance, up from the \$250,000 we added in 2007. With the luxury of a fully-funded Allowance, we made the conscious decision to stay ahead of the deteriorating economic climate and scrubbed the commercial loan portfolio of almost \$700,000 in potential problem loans. After having done so, we ended 2008 with a reserve ratio of 1.41%, still higher than our peer group's average of 1.37%. Note: as of this writing in early March 2009, we have added an additional \$300,000 to our Allowance, lifting the ratio to 1.54%, while at the same time keeping earnings on budget. In these uncertain times, maintaining credit quality and preserving capital are foremost in our minds.

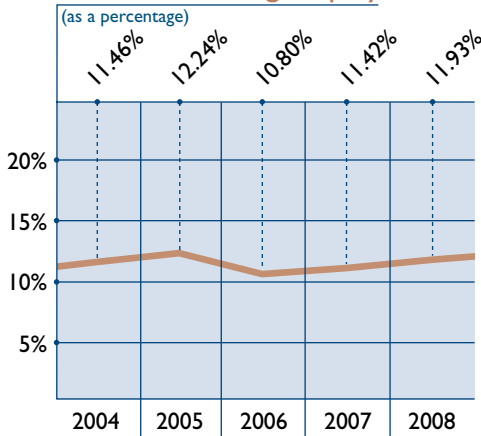
Allowance for Loan Losses



Book Value per Share



Return on Average Equity



We had a very respectable 4.1% growth in our deposit base in 2008, in spite of the fact that many of our larger competitors were paying abominably high rates for all types of deposits. These larger banks needed to pay up for deposits because of well-publicized financial woes. In fact, many secondary market sources cut off their access to funds, forcing them to pay above-market rates in our local areas. Nevertheless, our deposit growth funded our growth in assets and helped us reach another milestone – surpassing \$400 million in total assets. We ended 2008 with assets of \$411 million.

Over the years, I have discussed the industry's shrinking net interest margin; the difference between the interest income we earn on our loans and investments and the interest we pay to our depositors. To offset this decline in net interest income, Lyons National Bank has made strong efforts to improve its sources of other income, i.e., financial services income, mortgage loan servicing fees, cash management fees, etc. In 2008, our focus paid off, with our non-interest income growing by more than \$230,000, or 6%, over the 2007 level. However, we were pleasantly surprised that we were also able to increase our net interest margin last year – however so slightly – to 3.75% from 3.71% the year before. This improvement in margin is a tribute to our branch staff. They successfully generated enough non-interest bearing deposits (checking accounts) to offset the interest expense we paid to our depositors on their certificates of deposit and other interest-bearing accounts. By accomplishing this feat in the face of tough competition from our larger bank brethren that I discussed above, they once again proved, "It's all about people."

Controlling non-interest expenses is mandatory if we are to survive these very troubling times. I am proud to report that our continued focus on improving our efficiency ratio (the percentage of each dollar earned that is used to pay expenses) resulted in the ratio declining from 79% in 2007 to 76% in 2008, excluding the life insurance proceeds. Our longer-term

goal is to drive this ratio down into the mid-60% range. It will take the effort of the entire staff to achieve this goal; however, I'm encouraged by the "buy-in" our employees have shown towards achieving it. In my mind, it's not a question of "if", but "when"!

To again achieve record earnings in a period of tremendous financial turmoil is a testament to the entire Bank staff. Not only were they up to the task of maintaining the Bank's steady course in the face of a perfect storm, they like everyone else, had to cope with the crippling effects of skyrocketing gasoline prices and eroding retirement assets. Without their focus, dedication, professionalism, and probably most notably, their positive, can-do attitudes, our results would have been much different. I'm constantly amazed at what they continue to accomplish. I'm fortunate to be able to work with them!

PERSONAL NOTE

We lost two staunch supporters in 2008, Anthony "Tony" Paliotti and Albert Fenyvessy. Tony and Albert were long-time Directors of both the Holding Company and the Bank. We valued their counsel, wisdom, and most importantly, friendship. We miss them deeply.

RESIDENTIAL MORTGAGE PORTFOLIO

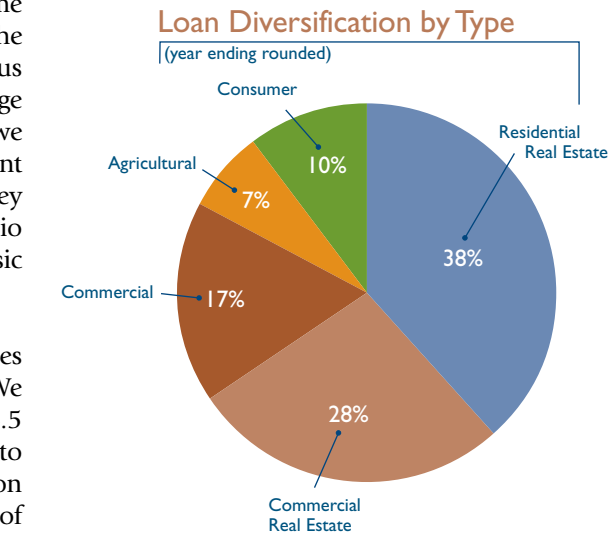
In 2006, we made a strategic decision to emphasize consumer lending at the Bank in order to balance the overall credit risk of the entire loan portfolio more equally between personal and business lines. From the end of 2005 to year-end 2008, we changed the mix of the loan portfolio from 66% commercial/agricultural and 34% consumer to 52% commercial/agricultural and 48% consumer. One of the main drivers of this strategy is our residential mortgage portfolio. While we have become more aggressive in the residential mortgage arena, you have heard me say numerous times that we did not participate in the sub-prime mortgage debacle. We take tremendous pride in the credit quality of our residential mortgage portfolio, especially over the past few years as we grew the portfolio. The following statistics represent mortgages closed during that period of growth. They give you some insight into the quality of the portfolio and will substantiate our claim of adhering to basic banking principles.

At year-end 2008, we held 593 residential mortgages in our balance sheet portfolio totaling \$57 million. We also serviced another 624 mortgages totaling \$54.5 million. We originated these loans but sold them to either the Federal Home Loan Mortgage Corporation (Freddie Mac) or the Federal Home Loan Bank of NY (FHLB). Because we continue to service these mortgages by taking payments and interceding on behalf of the customer if an issue should arise, the fact we have sold them is transparent to our customer. Whether we originate and hold or originate and sell a residential mortgage is purely a function of balance sheet management (i.e. level of interest rates, trend of interest rates, our need for longer-term assets, etc.) determined by the Bank's Asset/Liability Committee (ALCO). However, we underwrite each mortgage, whether it is held or sold, to the same high quality standards.

There are many criteria used to underwrite the creditworthiness of a residential mortgage. The three most common are: (1) loan to value (LTV); (2) debt to income ratio (D/I) which is defined as the customer's total monthly debt payments divided by their total monthly income from all sources; and (3) consumer credit score. The tables below depict the creditworthiness of our portfolio as measured by the various criteria.

1. Loan to Value (LTV)

Very few of our mortgages exceed 95% of the appraised value of a residential property. The few that do were part of a federal program like FHA that were sold to that agency. Furthermore, it is Bank policy that any mortgage that exceeds 80% LTV must be insured with Private Mortgage Insurance paid by the borrower. As of 12/31/08 the ranges of LTVs on the mortgages originated by the Bank over the past three years is as shown:



Loan to Value	Held in Portfolio	Sold
50% or less	10.46%	15.33%
51% to 70%	26.15%	30.21%
71% to 80%	43.38%	34.04%
81% to 90%	11.69%	9.79%
91% to 95%	8.00%	7.23%
96% or greater	0.32%	3.40%

2. Debt to Income Ratio (D/I)

It is Bank policy that we will not make a residential mortgage to anyone with a debt-to-income ratio that exceeds 45% without some other mitigating factor such as a low loan to value or exceptionally high credit score. As of 12/31/08 the range of D/I ratios on mortgages originated over the past two years by the Bank were:

Debt to Income Ratio	Held in Portfolio	Sold
30% or less	33.12%	27.78%
31% to 40%	28.66%	26.67%
41% to 50%	27.39%	22.22%
51% to 60%	5.73%	13.33%
61% or greater	5.10%	10.00%

3. Credit Score

The Bank follows the direction of The Comptroller of the Currency (OCC) when it considers an individual's credit score as criteria for approving a residential mortgage application. The OCC's benchmark credit score is 660. That score, or any higher one, is considered prime. We may approve an individual with a score of less than 660; however, in each case again there is a mitigating circumstance (i.e. low LTV or D/I) that made the decision prudent. The financial industry considers a credit score of 720 or better as excellent. Again, as of 12/31/08 and for mortgages originated over the past three years, customer credit scores fell into the ranges shown.

Credit Scores	Held in Portfolio	Sold
660 or less	7.07%	11.06%
661 to 700	8.64%	9.79%
701 to 750	19.26%	19.58%
751 to 800	36.50%	38.72%
801 or greater	28.53%	20.85%

80% of customers with scores of 700 or higher

One other aspect that should be considered when evaluating the quality of a residential mortgage portfolio is the purpose of the mortgage; i.e., is the home the primary residence, an investment or a vacation home? Along this line, our portfolio breakdown is as shown:

Mortgage Purpose	Held in Portfolio	Sold
Owner Occupied	88.54%	95.51%
Vacation or second home	3.20%	2.25%
Investment	8.26%	2.24%

Of course, portfolio statistics are only as good as your actual performance, and on this score, the number of foreclosures a portfolio experiences is the most important indicator of quality. I'm proud to say that since the year 2000, Lyons National Bank has foreclosed on only 11 homes. When you consider the thousands of loans we have handled in both the Bank-Held and Sold portfolios over this period, the record is great.

There has been a lot of talk recently about forcing banks to modify mortgages (reduce balances) rather than foreclose. Our approach is much more effective — we make good loans to responsible home-buyers so a foreclosure is a rare, not a regular, event. Furthermore, the circumstances pertaining to the majority of our foreclosures were usually extraordinary personal events such as death or divorce.

It could be argued that our lending standards are a bit too stringent. That may very well be the case. However, we take our fiduciary responsibility to our deposit customers and you, our shareholders, very seriously. Given current history, I'm more comfortable defending our stance than the one taken by some others in the industry.

CLOSING

Our conservative roots again served us well during this time of financial turmoil and uncertainty. We don't apologize for our culture, but rather take great pride in the fact that it helped us keep the ship steady in rough seas. We are equally proud that we did so without accepting any government assistance or "bailout". But, we also know our industry and the country in general face more difficult times ahead. We further understand that necessary government programs instituted to help others will increase our costs. While we will strongly debate the proper price we will ultimately have to pay for the transgressions of others, we understand the seriousness of the situation. To compensate, in 2009, we'll work smarter, harder and longer. The staff at the Bank has been challenged before and proved they were up to the task. Can we meet the challenge again – yes we can!

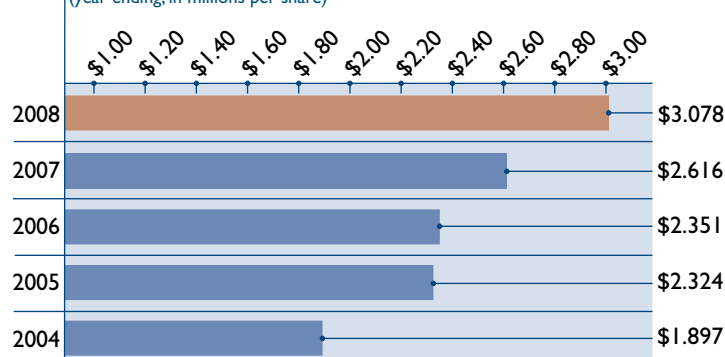
2008 Financial Highlights

RESULTS OF OPERATIONS

For the year ended December 31, 2008, we recorded earnings of \$3.1 million, an increase of \$462,000 or 17.7% over 2007. This translates into earnings per share of \$3.63 for the year ended 2008 or an 18.6% increase year over year. Return on average assets for 2008 was 0.79% versus 0.71% for 2007, and return on average equity for 2008 was 11.93% versus 11.42% for 2007. These numbers represent strong results for us, especially against the backdrop of the economic environment we have been operating in since late 2007.

Net Income

(year ending, in millions per share)



Our results of operations depend in large part on our net interest income, our largest revenue source. Net interest income is the difference between the interest income we earn on our interest-earning assets, primarily loans and investment securities, and the interest paid on our interest-bearing liabilities, primarily deposit accounts and borrowings. Net interest income for 2008 was \$13.5 million, an increase of \$963,000 or 7.7% over 2007. As the Federal Reserve has lowered its target rate by more than 300 basis points since the fourth quarter 2007, pressure to

maintain our net interest margin was challenging. Almost 25% of our loans reprice in concert with the Fed's target rate and investment yields began shrinking during 2008. However, with thoughtful pricing strategies coupled with an emphasis on building customer relationships, we were able to modestly improve our net interest margin in 2008, to 3.75%, from 3.71% during 2007 by managing funding costs.

Our results of operations also are affected by our provision for loan losses, which is based upon our assessment of a variety of factors, including loan credit quality, the general economic environment and growth in our loan portfolio. In 2008, we provided \$405,000 for loan losses, compared to \$250,000 in 2007. We have not experienced the credit issues that other areas of the country are facing. In fact, at December 31, 2008 our nonperforming loans are 1.09% of our total loans, down from 1.46% at December 31, 2007, and well below our peers of 2.04%. While these ratios point to our success, we continue to grow our loan portfolio, and given the uncertainty of these economic times, we felt it prudent to increase our provision accordingly.

Non-interest income is an important revenue source for us, and consists primarily of deposit account fees, brokerage and insurance fees, loan servicing fees, cardholder related fees, gains and losses on the sale or impairment of securities, and gains on the sale of loans. In 2008, non-interest income totaled \$3.9 million or 22.4% of all revenue sources, which is an increase of \$234,000 or 6.4% over 2007 levels. While we saw a decline in the amount of fee income generated from deposit account fees, we experienced an increase in loan servicing fees, cardholder fees and gains on the sale of loans. In addition, during 2008 we received proceeds on a life insurance policy, providing a one-time benefit of approximately \$249,000. We held no preferred stock of Fannie Mae or Freddie Mac (or of any other company for that matter), and had no "other than temporary impairment" write-downs that other financial institutions have been struggling with.

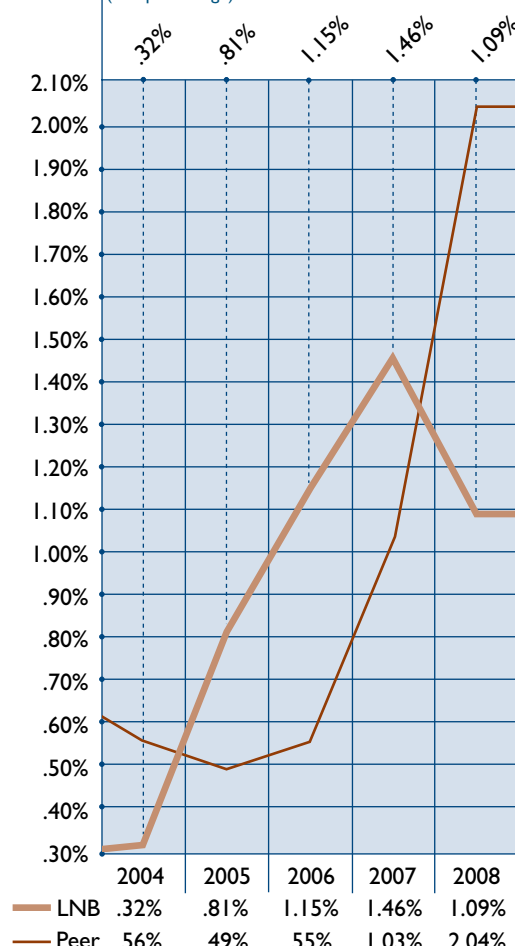
Controlling non-interest expense was a key focus for us this year, as we looked to build on our solid infrastructure and improve efficiencies. Non-interest expense consists primarily of compensation and employee benefits, occupancy and equipment expenses, advertising, data processing, professional fees, FDIC insurance, and other operating expenses. In 2008, total non-interest expense was \$13.0 million, an increase of \$181,000 or 1.4% over 2007. We achieved improvement of our efficiency



Diana R. Johnson
Executive Vice President &
Chief Financial Officer
Lyons Bancorp, Inc. and
The Lyons National Bank

Non-accruing Loans to Total Loans

(as a percentage)

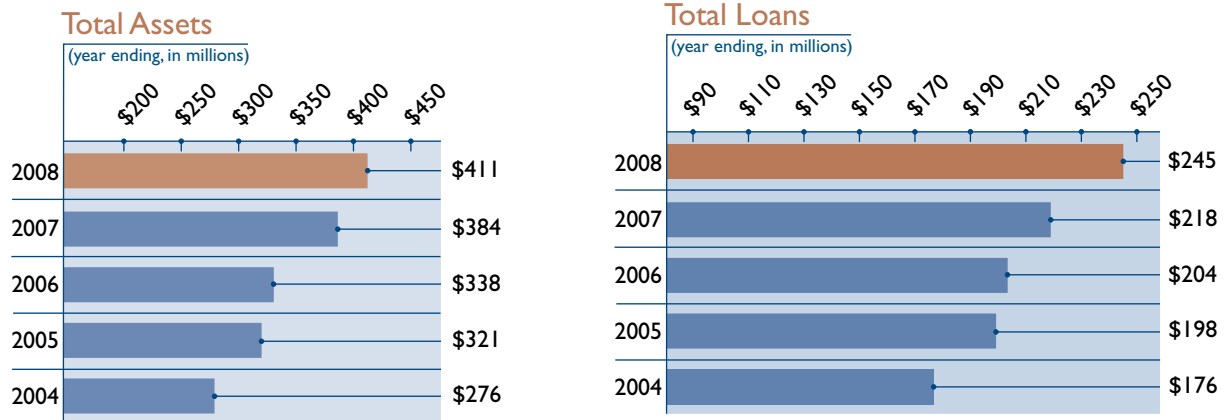


ratio, reducing the ratio from 79% to 76% during 2008 (excluding life insurance proceeds), due in part to a successful employee suggestion program called "Bright Ideas". This efficiency was achieved while continuing to provide excellent customer service with well trained staff, and we will continue in our efforts to improve efficiencies throughout 2009 and beyond.

Income tax expense was \$932,000 for 2008, compared to \$533,000 in 2007. As our level of taxable income increases at a quicker pace than our tax exempt income, our effective tax rate continues to rise. In 2008 and 2007 we have invested in tax exempt municipal securities and bank owned life insurance. In addition, our investment in our Geneva facility continues to provide us with New York State Empire Development Zone tax credits.

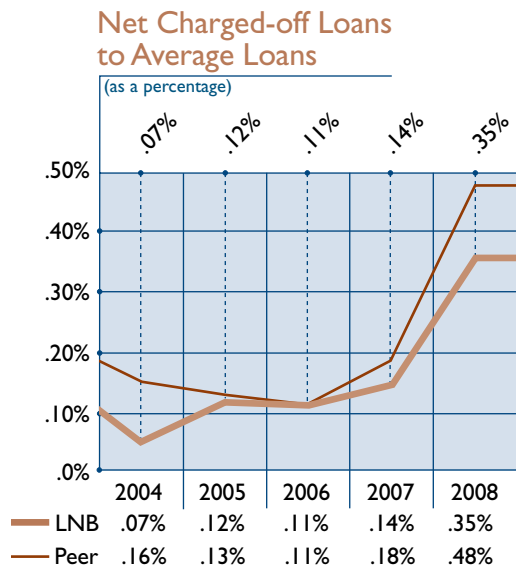
ANALYSIS OF FINANCIAL CONDITION

During 2008 we experienced solid loan and deposit growth across our organization, and broke through the \$400 million mark in total assets. Total assets on December 31, 2008 were \$411.5 million, an increase of \$27.1 million or 7.0% from \$384.4 million recorded on December 31, 2007. Average interest-bearing assets grew \$21.9 million during 2008 and was funded primarily by growth in deposits.



Total loans were \$245.5 million at December 31, 2008, an increase of \$27.6 million or 12.7% from December 31, 2007. We continued to support our strategy of balancing the loan portfolio more evenly between consumer and commercial loans, ending the year with 48% consumer-related loans versus 52% commercial-related loans. This is compared to 46% consumer-related loans at the end of 2007 and 39% at the end of 2006. Loan quality remained strong, with total non-performing loans of \$2.7 million at December 31, 2008, compared to \$3.2 million at December 31, 2007.

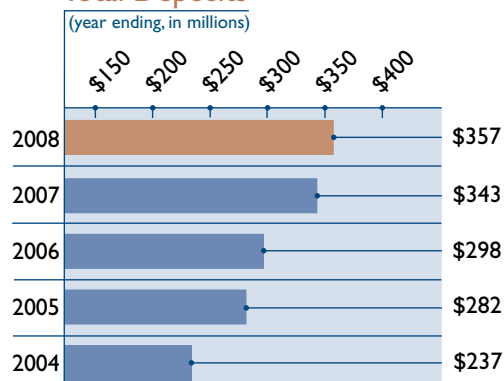
Net charge-offs for 2008 were \$794,000 during 2008, or 0.35% of average loans, well below our New York State peer group of 0.48%. We are well positioned to continue prudent lending to the individuals, families and businesses here in our Upstate New York marketplace and look forward to another year of solid loan growth.



We maintain an investment portfolio to provide us with important liquidity considerations and earnings potential. Our investment portfolio consists primarily of United States Agency debt, mortgage-backed securities either guaranteed by the U.S. government or issued by the Federal Home Loan Bank, and state and local government debt. As of December 31, 2008, our investment portfolio totaled \$134.5 million, an increase of \$18.2 million over December 31, 2007, and had an average yield of 4.44% during 2008. Substantially all of our investments are classified as available for sale, and may be used as collateral for public fund deposits.

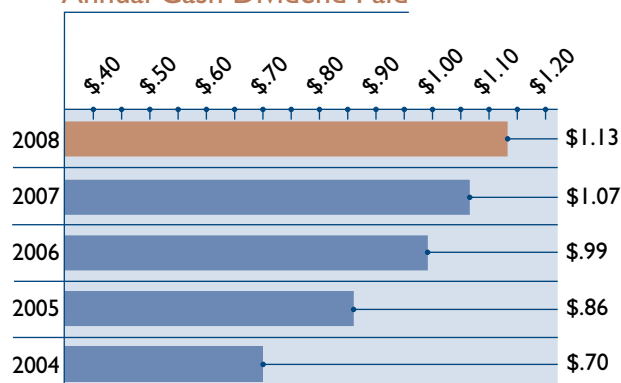
Deposits generated within our branch markets are the major source of funds for our lending and investment activities. Total deposits at December 31, 2008 were \$356.8 million, an increase of \$14.0 million or 4.1% over December 31, 2007. We were successful in growing our core deposit base by continuing to provide sound and trusted financial advice during these uncertain times. Much of our focus was on relationship building during 2008, with programs such as Remote Deposit Capture being introduced to our commercial customers. In addition, internet banking usage has increased year over year, providing our customers instant access to their accounts while allowing us to be more efficient in delivering products, services and information.

Total Deposits



Stockholders' equity was \$26.5 million at December 31, 2008, an increase of \$1.9 million or 7.8% from December 31, 2007. Our Board of Directors is committed to providing a solid return to our shareholders and authorized a total of \$1.13 per share in dividends to be paid during 2008. This represents a yield of 4.56% based on a current market price of \$24.75 per share and represents a dividend payout ratio of 31%.

Annual Cash Dividend Paid



Please refer to our Consolidated Financial Report as of December 31, 2008 for more information regarding our 2008 financial position and results.

SELECTED FINANCIAL DATA

Year Ended December 31

(in thousands, except per share data)

	2008	2007	2006	2005	2004
Financial Statement Highlights					
Assets	\$ 411,490	\$ 384,405	\$ 338,062	\$ 321,273	\$ 275,545
Loans, gross	245,457	217,834	203,627	197,890	175,790
Deposits	356,767	342,730	297,923	281,968	237,260
Other borrowings	17,642	7,489	9,098	9,655	11,474
Stockholders' equity	26,544	24,625	22,537	20,995	18,050
Interest and dividend income	20,788	21,999	19,493	16,330	12,179
Interest expense	7,285	9,459	7,150	5,036	2,993
Net interest income	13,503	12,540	12,343	11,294	9,186
Provision for loan losses	405	250	987	943	856
Net securities gains	71	20	0	146	275
Net income	3,078	2,616	2,351	2,324	1,897
Per Share Information					
Earnings per share	3.63	3.06	2.74	2.91	2.51
Cash dividends paid per share	1.13	1.07	0.99	0.86	0.70
Book value per share	31.29	28.79	26.31	24.46	22.87
Selected Ratios					
Return on average assets	0.79%	0.71%	0.71%	0.75%	0.77%
Return on average equity	11.93%	11.42%	10.80%	12.24%	11.46%
Leverage ratio (Bank)	8.32%	8.24%	8.62%	8.10%	8.38%
Dividend payout ratio	31.25%	35.02%	36.12%	29.44%	27.64%
Other Selected Data (in whole numbers)					
Employees (full time equivalent)	131	133	121	108	91

Board of Directors and Advisory Boards



Board of Directors left to right: James E. Santelli, Theodore J. Marshall, Andrew F. Fredericksen, Clair J. Britt, Jr., Robert A. Schick, Dale H. Hemminger, Carol A. Snook, Thomas L. Kime, James A. Homburger, John J. Werner, Jr. and David J. Breen, Jr.

BOARD OF DIRECTORS

Robert A. Schick
*President & Chief Executive Officer
Lyons Bancorp, Inc. &
The Lyons National Bank*

David J. Breen, Jr.
*General Manager
Herrema's Market Place*

Clair J. Britt, Jr.
*Executive Vice President &
Senior Commercial Lending Officer
The Lyons National Bank*

Andrew F. Fredericksen, CPA
*Senior Partner
Fredericksen & Sirianni, LLP*

Dale H. Hemminger
*President & General Manager
Hemdale Farms & Greenhouses*

James A. Homburger
Real Estate Broker

Thomas L. Kime
*Executive Vice President &
Chief Operating Officer
The Lyons National Bank*

Theodore J. Marshall
*President & Chief Executive Officer
Marshall Companies*

James E. Santelli
*Retired Vice President & Co-owner
Santelli Lumber Co.*

John J. Werner, Jr.
*Retired President &
Chief Executive Officer
Lyons Bancorp, Inc. &
The Lyons National Bank*

Carol A. Snook
*Banking Officer &
Corporate/Executive Secretary
The Lyons National Bank*

Our active and local Board members define us as a true Main Street bank, keeping us connected to our community as well as focused on sound banking principles and our responsibility to shareholders.



GENEVA ADVISORY BOARD

Peter J. D'Amico, Jr.
Joseph A. Fragnoli
Carl W. Fribolin
Bernard G. Lynch
Jane M. Shaffer
Bryan G. vonHahmann
Earl (Red) T. Wadhams

PENN YAN ADVISORY BOARD

Bonnie B. Curbeau
James H. Long
Michael D. Linehan
Paul W. Marble, Jr.
Henry H. Martin
Neil J. Simmons
William H. Sutherland

Top, Geneva Advisory Board seated left to right: Bryan G. vonHahmann, Carl W. Fribolin, Bernard G. Lynch; standing left to right: Jane M. Shaffer, Peter J. D'Amico, Jr. and Joseph A. Fragnoli (not pictured Earl (Red) T. Wadhams)

Bottom, Penn Yan Advisory Board seated left to right: Paul W. Marble, Jr., James H. Long, Bonnie B. Curbeau; standing left to right: William H. Sutherland, Michael D. Linehan and Neil J. Simmons (not pictured Henry H. Martin)

Bank Officers and Supervisors

ADMINISTRATION

Robert A. Schick
President & Chief Executive Officer

Thomas L. Kime
Executive Vice President & Chief Operating Officer

Carol A. Snook
Banking Officer & Corporate/Executive Secretary

AUDIT & COMPLIANCE

Ruth M. Columbus
Assistant Vice President & Director of Internal Audit

Joyce A. Marble
Assistant Vice President & Compliance/BSA Officer

BRANCH DIVISION

Thomas D. Muller
Senior Vice President & Director of Branch Sales

Susan K. Andersen
Vice President & Branch Manager – Penn Yan

Jeffrey A. Friend
Vice President & Branch Manager – Geneva

Jarrold D. Crawford
Assistant Vice President & Branch Manager – Newark

William L. Dungey
Assistant Vice President & Branch Manager – Clyde/Jordan

Sherri A. Sheldon
Assistant Vice President & Branch Manager – Wolcott

Jean E. Tsepas
Assistant Vice President & Branch Manager – Ontario

Darlene M. Whitcomb
Assistant Vice President & Branch Manager – Lyons

James S. Bilotta
Banking Officer & Branch Manager – Macedon

Julie B. Downey
Banking Officer & Assistant Branch Manager – Main Office

Susan L. Snyder
Banking Officer & Assistant Branch Manager – Penn Yan

Cathy J. DeMay
Banking Officer & Assistant Branch Manager – Ontario

Kathleen A. Wind
Banking Officer & Assistant Branch Manager – Newark

Evelyn L. Buisch
Assistant Branch Manager – Geneva

Deborah J. Burney
Assistant Branch Manager – Macedon

Jacqueline S. Hill
Assistant Branch Manager – Clyde

Donna L. Reuter
Assistant Branch Manager – Lyons

COMMERCIAL LENDING DIVISION

Clair J. Britt, Jr.
*Executive Vice President &
Senior Commercial Lending Officer*

James H. King
Vice President & Commercial Loan Officer

Scott A. Mackenzie
*Vice President & Agricultural/
Commercial Loan Officer*

Gregory R. MacDonald
*Assistant Vice President & Agricultural/
Commercial Loan Officer*

Anna M. Bridger
Assistant Vice President & Commercial Loan Officer

John O'Connor
Assistant Vice President & Commercial Loan Officer

Darrin Brentnall
Banking Officer & Commercial Loan Officer

Lynnette M. Zelias
Commercial Loan Operations Manager

CREDIT ADMINISTRATION

Pamela J. Lee
Vice President & Credit Administration Manager

FINANCE DIVISION

Diana R. Johnson
Executive Vice President & Chief Financial Officer

Chad J. Proper
Banking Officer & Financial Analyst

Brenda L. Cordero
Accounting Manager



*Executive Management
seated, left to right:
Diana R. Johnson,
Robert A. Schick;
standing, left to right:
Stephen V. DeRaddo,
Thomas L. Kime and
Clair J. Britt, Jr.*

FINANCIAL SERVICES

Robert T. Koczent
Vice President & Director of Financial Services

Gary F. Teague
Financial Services Officer

HUMAN RESOURCES

Kimberly A. Kelley
Assistant Vice President & Director of Human Resources

Trevor Thomas
Assistant Vice President & Director of Training

MARKETING DIVISION

Shelly M. Nicoletta
Director of Marketing

OPERATIONS & IT DIVISION

Cheryl M. Graham
*Assistant Vice President & Process Improvement/
Operations & Procedures Manager*

Todd F. Juffs
Assistant Vice President & MIS Officer

RETAIL LENDING DIVISION

Stephen V. DeRaddo
Executive Vice President & Senior Retail Lending Officer

Thomas R. David
Assistant Vice President & Mortgage Loan Officer

Robert T. MacDonell
Vice President & Consumer Loan Officer

Timothy H. Lead
Assistant Vice President & Mortgage Loan Officer

Joshua N. Miller
Vice President & Mortgage Loan Officer

Hope A. Alexanian
Assistant Vice President & Retail Loan Operations Manager

SECURITY & FACILITIES DIVISION

Randall G. Phillips
Security Officer & Facilities Manager

Exceeding Expectations



Penn Yan Branch Manager Sue Andersen with LNB mortgage customers David and Lorinda Owens.

SINCE 1852, LNB has been dedicated to exceeding the expectations of our shareholders and those of our customers. As opposed to some other financial institutions, we have done so by consistently providing our customers with appropriate financial products and services that benefit our customer, while at the same time adhere to sound banking principles. This philosophy has not only allowed us to continue to meet our customers' varied financial needs during these challenging times, but has enabled us to significantly increase our loan production in areas such as residential mortgages, while maintaining our loan quality standards.

Our goal for 2009 is to continue to prudently grow our loan portfolio as well as our sold and serviced residential mortgage portfolio. Our 2009 residential mortgage originations are already well on their way to surpassing our strong 2008 results.

Call any one of our full-service offices listed on the back cover to see how we can exceed your expectations.

Consolidated Financial Report

December 31, 2008



INDEPENDENT AUDITOR'S REPORT

To the Stockholders and Board of Directors of Lyons Bancorp, Inc.
Lyons, New York

We have audited the consolidated balance sheets of Lyons Bancorp, Inc. and subsidiary as of December 31, 2008 and 2007, and the related consolidated statements of income, 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 auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated 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 consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Lyons Bancorp, Inc. and subsidiary as of December 31, 2008 and 2007, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Beard Miller Company LLP

Beard Miller Company LLP
Syracuse, New York
March 20, 2009

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ANNUAL MEETING

The annual meeting of the stockholders will take place at 4:30 p.m. on **May 20, 2009** at the historic Ohmann Theatre in Lyons, New York.

Consolidated Balance Sheets

December 31, 2008 and 2007

	<u>2008</u>	<u>2007</u>
ASSETS		
Cash and due from banks	\$ 9,423,539	\$ 13,092,059
Federal funds sold	168,964	16,915,292
Interest-bearing deposits in banks	<u>2,429,317</u>	<u>490,768</u>
Cash and Cash Equivalents	12,021,820	30,498,119
Trading securities, at fair value	–	19,799,146
Investment securities:		
Available for sale	128,858,315	91,806,801
Held to maturity	4,019,564	3,707,666
Restricted equity securities, at cost	<u>1,573,521</u>	<u>971,901</u>
Total Investment Securities	134,451,400	96,486,368
Loans	245,457,095	217,834,276
Less allowance for loan losses	<u>(3,471,854)</u>	<u>(3,860,924)</u>
Net Loans	241,985,241	213,973,352
Land, premises and equipment, net	11,174,903	11,527,732
Bank owned life insurance	5,802,368	6,412,775
Accrued interest receivable and other assets	<u>6,054,316</u>	<u>5,707,076</u>
Total Assets	<u>\$ 411,490,048</u>	<u>\$ 384,404,568</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Deposits:		
Interest-bearing	\$ 293,899,040	\$ 284,700,067
Non-interest-bearing	<u>62,867,952</u>	<u>58,029,462</u>
Total Deposits	356,766,992	342,729,529
Securities sold under agreements to repurchase	8,642,295	6,489,099
Borrowings from Federal Home Loan Bank	9,000,000	1,000,000
Junior subordinated debentures	6,190,000	6,190,000
Accrued interest payable and other liabilities	<u>4,290,420</u>	<u>3,314,673</u>
Total Liabilities	<u>384,889,707</u>	<u>359,723,301</u>
Minority interest	<u>56,000</u>	<u>56,000</u>
Stockholders' Equity		
Common stock	433,832	433,832
Paid-in capital	7,904,900	7,942,761
Retained earnings	18,820,393	16,750,093
Accumulated other comprehensive loss	(12,821)	(127,371)
Treasury stock, at cost	<u>(601,963)</u>	<u>(374,048)</u>
Total Stockholders' Equity	<u>26,544,341</u>	<u>24,625,267</u>
Total Liabilities and Stockholders' Equity	<u>\$ 411,490,048</u>	<u>\$ 384,404,568</u>

See notes to consolidated financial statements.

Consolidated Statements of Income

Years Ended December 31, 2008 and 2007

	<u>2008</u>	<u>2007</u>
INTEREST INCOME		
Loans	\$ 14,964,256	\$ 15,949,974
Investment securities:		
Taxable	5,083,882	5,152,155
Non-taxable	740,047	896,915
Total Interest Income	<u>20,788,185</u>	<u>21,999,044</u>
INTEREST EXPENSE		
Deposits	6,704,855	8,768,429
Borrowings	580,599	690,823
Total Interest Expense	<u>7,285,454</u>	<u>9,459,252</u>
Net Interest Income	13,502,731	12,539,792
PROVISION FOR LOAN LOSSES	<u>405,000</u>	<u>250,000</u>
Net Interest Income after Provision for Loan Losses	<u>13,097,731</u>	<u>12,289,792</u>
NON-INTEREST INCOME		
Service charges and fees	3,232,280	3,340,665
Net trading securities losses	(19,294)	(11,051)
Net realized gains from calls of available for sale securities	71,255	19,630
Realized gains on loans sold	105,441	61,976
Realized gains (losses) on other assets sold	5,771	(8,320)
Increase in cash surrender value of bank owned life insurance	222,807	224,844
Life insurance benefit	249,465	-
Other	31,246	36,807
Total Non-interest Income	<u>3,898,971</u>	<u>3,664,551</u>
NON-INTEREST EXPENSE		
Salaries and wages	5,723,042	5,468,817
Pensions and benefits	1,618,081	1,462,963
Occupancy	1,782,467	1,702,727
Professional fees	664,302	687,658
Data processing	635,688	613,963
FDIC and OCC assessments	483,395	411,426
Loan fees	334,418	442,590
Advertising	243,599	343,772
Office supplies	243,245	248,346
Other	1,253,670	1,418,277
Total Non-interest Expense	<u>12,981,907</u>	<u>12,800,539</u>
Income before Minority Interest and Income Taxes	<u>4,014,795</u>	<u>3,153,804</u>
MINORITY INTEREST	4,760	4,760
Income before Income Taxes	<u>4,010,035</u>	<u>3,149,044</u>
INCOME TAX EXPENSE	932,000	533,150
Net Income	<u>\$ 3,078,035</u>	<u>\$ 2,615,894</u>
EARNINGS PER SHARE	<u>\$ 3.63</u>	<u>\$ 3.06</u>

See notes to consolidated financial statements.

Consolidated Statements of Stockholders' Equity

Years Ended December 31, 2008 and 2007

	Common Stock	Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total
BALANCE – JANUARY 1, 2007	\$ 433,832	\$ 7,896,566	\$ 15,411,896	\$ (915,263)	\$ (290,378)	\$ 22,536,653
Comprehensive income:						
Net income	–	–	2,615,894	–	–	2,615,894
Change in unrealized net loss on securities available for sale, net of tax	–	–	–	303,362	–	303,362
Change in unrealized loss on pension and postretirement benefits, net of tax	–	–	–	139,791	–	139,791
Total Comprehensive Income						3,059,047
Cumulative effect adjustment, adoption of FASB Statement No. 159, net of tax of \$229,829	–	–	(344,739)	344,739	–	–
Purchase of treasury stock	–	96	–	–	(37,571)	(37,475)
Deferred compensation shares awarded, net	–	81,516	–	–	(81,516)	–
Deferred compensation shares vested	–	(40,758)	–	–	40,758	–
Deferred compensation shares redeemed	–	5,341	–	–	(5,341)	–
Cash dividends declared, \$1.09 per share	–	–	(932,958)	–	–	(932,958)
BALANCE – DECEMBER 31, 2007	433,832	7,942,761	16,750,093	(127,371)	(374,048)	24,625,267
Comprehensive income:						
Net income	–	–	3,078,035	–	–	3,078,035
Change in unrealized net gain on securities available for sale, net of tax	–	–	–	996,739	–	996,739
Change in unrealized loss on pension and postretirement benefits, net of tax	–	–	–	(882,189)	–	(882,189)
Total Comprehensive Income						3,192,585
Cumulative effect adjustment, adoption of measurement date provision of FASB Statement No. 158, net of tax of \$35,765	–	–	(53,647)	–	–	(53,647)
Purchase of treasury stock	–	–	–	–	(854,432)	(854,432)
Issuance of treasury stock	–	8,990	–	–	620,116	629,106
Deferred compensation shares awarded, net	–	–	–	–	(84,644)	(84,644)
Deferred compensation shares vested	–	(46,851)	–	–	91,045	44,194
Cash dividends declared, \$1.14 per share	–	–	(954,088)	–	–	(954,088)
BALANCE – DECEMBER 31, 2008	\$ 433,832	\$ 7,904,900	\$ 18,820,393	\$ (12,821)	\$ (601,963)	\$ 26,544,341

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Years Ended December 31, 2008 and 2007

	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 3,078,035	\$ 2,615,894
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	405,000	250,000
Earnings on investment in bank owned life insurance	(222,807)	(224,844)
Life insurance benefits	(249,465)	–
Net realized gain from calls of available for sale securities	(71,255)	(19,630)
Realized gains on loans sold	(105,441)	(61,976)
Deferred compensation expense	62,027	87,083
Net accretion on securities	(14,754)	(51,198)
Mark to market loss (gain) on trading assets	19,294	(7,249)
Purchases of trading assets	(2,987,108)	(26,145,188)
Proceeds from sales of trading assets	–	23,506,756
Proceeds from maturities of trading assets	3,927,986	7,531,418
Net cash loss on sales of trading assets	–	18,300
Depreciation	778,113	760,801
Deferred income tax benefit	(175,821)	(336,079)
Increase in accrued interest receivable and other assets	(581,014)	(601,673)
Increase (decrease) in accrued interest payable and other liabilities	(284,749)	1,204,260
Loans originated for sale	(11,629,185)	(11,780,595)
Proceeds from sales of loans	11,886,750	11,525,920
Net Cash Provided by Operating Activities	3,835,606	8,272,000
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of securities available for sale	(88,165,991)	(50,953,754)
Proceeds from sales of securities available for sale	–	40,300
Proceeds from maturities of and calls of securities available for sale	71,099,074	35,769,461
Purchases of held to maturity securities	(1,869,452)	(2,956,187)
Proceeds from maturities of securities held to maturity	1,557,553	3,866,917
Net increase in loans	(28,620,513)	(14,310,863)
Purchase of bank owned life insurance	–	(1,500,000)
Proceeds from bank owned life insurance	1,082,679	–
Premises and equipment purchases, net	(412,952)	(2,342,848)
Net Cash Used in Investing Activities	(45,329,602)	(32,386,974)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in demand and savings deposits	18,856,246	24,175,364
Net increase (decrease) in time deposits	(4,818,783)	20,631,344
Net increase (decrease) in securities sold under agreements to repurchase	2,153,196	(408,470)
Increase (decrease) in borrowings from Federal Home Loan Bank	8,000,000	(1,200,000)
Purchase of treasury stock	(854,432)	(37,475)
Issuance of treasury stock	629,106	–
Dividends paid	(947,636)	(916,150)
Net Cash Provided by Financing Activities	23,017,697	42,244,613
Net Increase (Decrease) in Cash and Cash Equivalents	(18,476,299)	18,129,639
CASH AND CASH EQUIVALENTS – BEGINNING	30,498,119	12,368,480
CASH AND CASH EQUIVALENTS – ENDING	\$ 12,021,820	\$ 30,498,119
SUPPLEMENTARY CASH FLOW INFORMATION		
Interest paid	\$ 7,473,726	\$ 9,454,446
Income taxes paid	\$ 1,209,799	\$ 615,000
NON-CASH DISCLOSURE		
Transfer of trading securities to available for sale securities	\$ 18,850,926	\$ –

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

Years Ended December 31, 2008 and 2007

NOTE I – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Lyons Bancorp, Inc. (the Company) provides a full range of commercial banking services to individual and small business customers through its wholly-owned subsidiary, The Lyons National Bank (the Bank). The Bank's operations are conducted in ten branches located in Wayne, Onondaga, Yates, and Ontario Counties, New York. The Company and the Bank are subject to the regulations of certain federal agencies and undergo periodic examinations by those regulatory authorities.

The Company also owns all of the voting common shares of Lyons Capital Statutory Trust I (Trust I) and Lyons Capital Statutory Trust II (Trust II).

The Bank also owns all of the voting stock of Lyons Realty Associates Corp. (LRAC) and LNB Life Agency, Inc. (LNB Life). LRAC is a real estate investment trust which holds a portfolio of real estate mortgages. In order to maintain its status as a real estate investment trust, LRAC holds the real estate mortgages until they are paid. The real estate mortgages held by LRAC are included in loans on the consolidated balance sheet. LNB Life provides non-insured financial services and products to the Bank's customers.

Basis of Consolidation

The consolidated financial statements include the accounts of the Company, the Bank, LRAC and LNB Life. All significant intercompany accounts and transactions have been eliminated in consolidation.

The accounts of Trust I and Trust II are not included in the consolidated financial statements as discussed in Note 9.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near future relate to the determination of the allowance and provision for loan losses, amounts associated with the Company's benefit plans and deferred tax assets and liabilities.

New Accounting Pronouncements

In December 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 141, "Business Combinations (Revised 2007)" (SFAS 141R). SFAS 141R replaces SFAS 141, "Business Combinations," and applies to all transactions and other events in which one entity obtains control over one or more other businesses. SFAS 141R requires an acquirer, upon initially obtaining control of another entity, to recognize the assets, liabilities and any non-controlling interest in the acquiree at fair value as of the acquisition date. Contingent consideration is required to be recognized and measured at fair value on the date of acquisition rather than at a later date when the amount of that consideration may be determinable beyond a reasonable doubt. This fair value approach replaces the cost-allocation process required under SFAS 141 whereby the cost of an acquisition was allocated to the individual assets acquired and liabilities assumed based on their estimated fair value. SFAS 141R requires acquirers to expense acquisition-related costs as incurred rather than allocating such costs to the assets acquired and liabilities assumed, as was previously the case under SFAS 141. Under SFAS 141R, the requirements of SFAS 146, "Accounting for Costs Associated with Exit or Disposal Activities," would have to be met in order to accrue for a restructuring plan in purchase accounting. Pre-acquisition

contingencies are to be recognized at fair value, unless it is a non-contractual contingency that is not likely to materialize, in which case, nothing should be recognized in purchase accounting and, instead, that contingency would be subject to the probable and estimable recognition criteria of SFAS 5, "Accounting for Contingencies." SFAS 141R may have a significant impact on any future business combinations closing on or after January 1, 2009.

In December 2007, the FASB issued SFAS No. 160, "Non-controlling Interest in Consolidated Financial Statements, an amendment of ARB No. 51." SFAS 160 amends Accounting Research Bulletin (ARB) No. 51, "Consolidated Financial Statements," to establish accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 clarifies that a non-controlling interest in a subsidiary, which is sometimes referred to as a minority interest, is an ownership interest in the consolidated entity that should be reported as a component of equity in the consolidated financial statements. Among other requirements, SFAS 160 requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the non-controlling interest. It also requires disclosure, on the face of the consolidated income statement, of the amounts of consolidated net income attributable to the parent and to the non-controlling interest. SFAS 160 is effective on January 1, 2009 and is not expected to have a significant impact on the Company's financial statements.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133". SFAS 161 requires entities that utilize derivative instruments to provide qualitative disclosures about their objectives and strategies for using such instruments, as well as any details of credit-risk-related contingent features contained within derivatives. Statement 161 also requires entities to disclose additional information about the amounts and location of derivatives located within the financial statements, how the provisions of SFAS 133 has been applied, and the impact that hedges have on an entity's financial position, financial performance, and cash flows. SFAS 161 is effective for the Company's fiscal 2009 financial statements. The format and specific disclosures related to the Company's derivative activity, if any, will depend upon the nature of its derivative's activity at that time.

Investment Securities

Securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them until maturity. Securities to be held for indefinite periods of time are classified as available for sale and carried at fair value, with the unrealized holding gains and losses reported as a component of other comprehensive income, net of tax. Securities held for resale for liquidity purposes are classified as trading and are carried at fair value, with changes in unrealized holding gains and losses included in income. Management determines the appropriate classification of securities at the time of purchase. Equity securities consist primarily of Federal Reserve Bank and the Federal Home Loan Bank stock. Effective January 1, 2007, management early-adopted SFAS No. 159 "The Fair Value Option for Financial Assets and Liabilities – Including an amendment to FASB Statement 115" (SFAS 159). See Note 3 to the consolidated financial statements for additional details.

Purchase premiums and discounts are recognized in interest income using the interest method or methods that approximate the interest method over the terms of the securities. Interest and dividends on securities are recognized in interest income using the specific identification method. Declines in the fair value of held to maturity and available for sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a reasonable period of time sufficient to allow for any anticipated recovery in fair

NOTE I – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *continued*

value. There were no impairment losses during 2008 or 2007. Gains and losses on the sale of securities are determined using the specific identification method.

Loans

The Bank grants mortgage, commercial and consumer loans to its customers. A substantial portion of the loan portfolio is represented by mortgage loans in Wayne, Ontario, Yates, and Onondaga Counties. The ability of the Bank's debtors to honor their contracts is primarily dependent upon the real estate and general economic conditions in those areas.

Beginning in 2008, loans are reported at their outstanding unpaid principal balances net of deferred origination costs and fees, as per SFAS No. 91, "Accounting for Non-refundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases" net of the allowance for loan losses. Interest and deferred fees and costs on loans are credited to income based on the effective interest method. Prior to 2008, net loan origination fees and costs were deemed insignificant and recognized as received or incurred in non-interest income and non-interest expense, respectively.

Interest income is accrued on the unpaid principal balance. The accrual of interest on loans is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in process of collection. Credit card loans and other personal loans are typically charged off no later than 180 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on non-accrual 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 non-accrual or charged off is reversed against interest income or the allowance for loan losses if the interest income was earned in a prior period.

The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Loans Held for Sale

Generally, loans held for sale consist of residential mortgage loans that are originated and are intended to be sold through agreements the Bank has with the Federal Home Loan Bank (FHLB) and the Federal Home Loan Mortgage Corporation (Freddie Mac). From time to time, the Bank may also hold commercial loans for sale. Realized gains and losses on sales are computed using the specific identification method. These loans are carried on the consolidated balance sheet at the lower of cost or estimated fair value determined in the aggregate.

The Bank retains the servicing on loans sold and receives a fee based upon the principal balance outstanding. Servicing rights included in the consolidated balance sheets totaled \$138,796 and \$126,341, net of amortization, as of December 31, 2008 and 2007, respectively.

Total loans serviced for others amounted to \$65,530,276 and \$62,122,122 at December 31, 2008 and 2007, respectively.

Loans held for sale totaled \$1,270,626 and \$1,422,750 at December 31, 2008 and 2007, respectively, and are included in loans on the consolidated balance sheets.

Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred in the loan portfolio. The allowance for loan losses is recorded 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 collectibility 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.

The allowance consists of specific, general and unallocated components. The specific component relates to certain individual loans that are classified as doubtful, substandard or special mention. For such loans that are also classified as impaired, a specific allowance is generally established when the collateral value of an 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 reflecting current conditions. 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 Bank 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 and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate 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 Bank does not separately identify individual consumer and residential loans for impairment disclosures.

Land, Premises and Equipment

Land is stated at cost. Premises and equipment are recorded at cost and are depreciated using accelerated methods over the estimated useful lives of the assets.

Foreclosed Real Estate

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

NOTE I – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *continued*

Bank Owned Life Insurance

Bank owned life insurance (BOLI) was purchased by the Bank as a financing tool for employee benefits and to fund discriminatory retirement benefits for the Board of Directors and executive management. The value of life insurance financing is the tax preferred status of increases in life insurance cash values and death benefits and the cash flow generated at the death of the insured. The purchase of the life insurance policy results in tax-exempt income to the Company. The largest risk to the BOLI program is credit risk of the insurance carriers. To mitigate this risk, annual financial condition reviews are completed on all carriers. BOLI is stated on the Company's consolidated balance sheets at its current cash surrender value. Increases in BOLI's cash surrender value are reported as non-interest income in the Company's consolidated income statement.

Treasury Stock

Treasury stock is recorded at cost. Shares are reissued on the average cost method, except for issuance of deferred compensation shares, which are discussed in Note 12.

Minority Interest

Minority interest represents the portion of ownership and interest expense that is attributable to the minority owners of LRAC.

Income Taxes

Income taxes are provided for the tax effects of certain transactions reported in the consolidated financial statements. Income taxes consist of taxes currently due plus deferred taxes related primarily to temporary differences between the financial reporting and income tax basis of the allowance for loan losses, premises and equipment, and prepaid and accrued employee benefits. The deferred tax assets and liabilities represent the future tax return consequences of the temporary differences, which will either be taxable or deductible when the assets and liabilities are recovered or settled. Deferred tax assets and liabilities are reflected at income tax rates applicable to the period in which the deferred tax assets and liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

In December 2008, the Financial Accounting Standards Board issued FASB Staff Position (FSP) FIN 48-3, "Effective Date of FASB Interpretation No. 48 for Certain Nonpublic Enterprises." The FSP defers the effective date of FASB Interpretation No. 48 (FIN 48), "Accounting for Uncertainty in Income Taxes," to be effective for fiscal years beginning after December 15, 2008 for certain nonpublic enterprises. The Company has elected to defer the application of FIN 48. For the years ended December 31, 2008 and 2007 the Company has accounted for uncertain tax positions in accordance with Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies."

Transfers of Financial Assets

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

Net Income Per Share

Net income per share is computed by dividing net income by the weighted average number of common shares outstanding during the year. The average number of shares outstanding were 847,064 and 854,982 for 2008 and 2007, respectively.

Statements of Cash Flows

For the purpose of presentation in the consolidated statements of cash flows, cash and cash equivalents are defined as the sum of cash and due from banks, federal funds sold, and interest-bearing deposits in banks.

Off-Balance-Sheet Financial Instruments

In the ordinary course of business, the Bank has entered into off-balance-sheet financial instruments consisting of commitments to extend credit and standby letters of credit. Such financial instruments are recorded in the consolidated financial statements when they are funded or related fees are incurred or received.

Reclassifications

Certain amounts appearing in the 2007 consolidated financial statements were reclassified to conform with the 2008 presentation. These reclassifications did not have a material impact on the consolidated financial statements and did not have any impact on stockholders' equity or net income.

NOTE 2 – RESTRICTIONS ON CASH AND DUE FROM BANKS

The Bank is required to maintain reserve funds in cash and/or on deposit with the Federal Reserve Bank. The required reserve at December 31, 2008 and 2007 was \$5,989,000 and \$5,702,000, respectively.

The Bank is also required to maintain clearing balance funds on deposit with the Federal Reserve Bank. The required minimum clearing balance at December 31, 2008 and 2007 was \$600,000.

NOTE 3 – INVESTMENTS

Trading securities consist of the following at December 31, 2008 and 2007:

	2008	2007
United States agencies	\$ —	\$ 15,445,924
Mortgage backed securities	—	4,353,222
Total Trading Securities	\$ —	\$ 19,799,146

NOTE 3 – INVESTMENTS *continued*

The amortized cost and fair value of investment securities, with gross unrealized gains and losses, are as follows at December 31, 2008 and 2007:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
DECEMBER 31, 2008				
Available for Sale:				
United States agencies	\$ 55,639,402	\$ 577,116	\$ (8,000)	\$ 56,208,518
State and local governments	20,266,561	162,840	(48,603)	20,380,798
Mortgage-backed securities	51,278,928	1,000,480	(10,409)	52,268,999
Total Debt Securities	\$ 127,184,891	\$ 1,740,436	\$ (67,012)	\$ 128,858,315
Held to Maturity:				
Local governments	\$ 4,019,564	\$ –	\$ –	\$ 4,019,564
Equity Securities	\$ 1,573,521	\$ –	\$ –	\$ 1,573,521
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
DECEMBER 31, 2007				
Available for Sale:				
United States agencies	\$ 46,245,119	\$ 216,270	\$ (31,425)	\$ 46,429,964
State and local governments	17,458,993	34,376	(30,223)	17,463,146
Mortgage-backed securities	28,090,496	70,961	(247,766)	27,913,691
Total Debt Securities	\$ 91,794,608	\$ 321,607	\$ (309,414)	\$ 91,806,801
Held to Maturity:				
Local governments	\$ 3,707,666	\$ –	\$ –	\$ 3,707,666
Equity Securities	\$ 971,901	\$ –	\$ –	\$ 971,901

Equity securities consist of stock of the Federal Reserve Bank of New York, the Federal Home Loan Bank of New York, New York State Business Development Corporation, Atlantic Central Bankers Bank, New Century Fund and New York Title Agency West.

The following table sets forth the Company's investment in securities with unrealized losses of less than twelve months and unrealized losses of twelve months or more at December 31:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
DECEMBER 31, 2008						
United States agencies	\$ 3,492,000	\$ 8,000	\$ —	\$ —	\$ 3,492,000	\$ 8,000
State and local governments	4,566,782	48,603	—	—	4,566,782	48,603
Mortgage-backed securities	3,255,112	10,409	—	—	3,255,112	10,409
	<u>\$ 11,313,894</u>	<u>\$ 67,012</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 11,313,894</u>	<u>\$ 67,012</u>
DECEMBER 31, 2007						
United States agencies	\$ 3,966,120	\$ 27,007	\$ 4,993,950	\$ 4,418	\$ 8,960,070	\$ 31,425
State and local governments	—	—	10,569,196	30,223	10,569,196	30,223
Mortgage-backed securities	17,946,134	247,766	—	—	17,946,134	247,766
	<u>\$ 21,912,254</u>	<u>\$ 274,773</u>	<u>\$ 15,563,146</u>	<u>\$ 34,641</u>	<u>\$ 37,475,400</u>	<u>\$ 309,414</u>

Unrealized losses on these securities have not been recognized into earnings because the issuers of the securities are of high credit quality, management has the ability and intent to hold these securities until maturity or market price recovery, and in management's opinion, the declines in fair value are largely due to market interest rates. The fair values of these securities are expected to recover as they approach maturity and/or market interest rates fluctuate. At December 31, 2008, no securities had unrealized losses for twelve months or longer, while twenty-eight securities had losses for less than twelve months. At December 31, 2007, forty-eight securities had unrealized losses for twelve months or longer, while ten securities had losses for less than twelve months

The amortized cost and fair value of debt securities at December 31, 2008, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations without call or prepayment penalties.

	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	\$ 3,580,092	\$ 3,591,836	\$ 1,727,746	\$ 1,727,746
Due after one year through five years	25,507,119	25,912,414	980,894	980,894
Due after five years through ten years	20,550,077	20,718,974	737,068	737,068
Due after ten years	26,268,675	26,366,092	573,856	573,856
Securities not due at a single maturity date	51,278,928	52,268,999	—	—
	<u>\$ 127,184,891</u>	<u>\$ 128,858,315</u>	<u>\$ 4,019,564</u>	<u>\$ 4,019,564</u>

NOTE 3 – INVESTMENTS *continued*

Effective January 1, 2007, the Company early adopted SFAS 159 for certain securities within its available-for-sale portfolio. These securities had an aggregate fair value of \$25.3 million as of the date of adoption. The Company selected these securities based upon yields and average remaining lives. The securities selected were fixed rate securities, with yields generally less than 4.50% and average lives greater than 1.5 years. As a result of the election to early adopt, the cumulative unrealized gross loss related to these available-for-sale securities of \$574,568 was recorded directly in the Company's consolidated financial statements as a cumulative-effect adjustment, net of tax, to retained earnings. The net of tax amount of \$344,739 was previously included within accumulated other comprehensive loss as of December 31, 2006. The Company changed its intent with respect to these securities so that it could record the losses directly to retained earnings rather than current income based on the transition provisions of SFAS 159 and after evaluating various alternative investments that could have improved returns and met certain liquidity objectives that more closely match the Company's needs.

In April 2007, the Company initiated a securities portfolio restructuring transaction whereby it sold the \$25.3 million in securities that were carried in the Company's trading portfolio subsequent to the adoption of SFAS 159, which resulted in a pre-tax loss of \$64,948. Proceeds from the sale were reinvested in trading securities that provide for a higher yield and will also reflect an improvement in the Company's liquidity and interest rate risk exposure position. Mark-to-market adjustments of \$19,294 and \$53,897 are reflected in the Company's 2008 and 2007 consolidated statements of income respectively, in net trading securities losses.

As of October 31, 2008, the Company eliminated its trading portfolio and transferred all securities previously classified as trading securities into its available for sale portfolio. The assets were transferred at their current fair value of \$18,850,926, with any market gains or losses recorded as additional premiums or discounts that are being amortized into interest income using the interest method over the remaining life of the investment. The Company intends to continue using these securities for liquidity enhancement.

During 2008, the Bank did not sell available-for-sale securities. During 2007, the Bank sold available-for-sale securities totaling \$40,300, resulting in no gross gains or losses. Investment securities with carrying amounts of \$85,322,478 and \$71,107,794 at December 31, 2008 and 2007, respectively, were pledged to secure deposits as required or permitted by law.

NOTE 4 – LOANS

Loans consist of the following at December 31, 2008 and 2007:

	2008	2007
Residential real estate	\$ 93,277,447	\$ 75,311,490
Commercial real estate	67,476,332	65,275,039
Commercial	59,409,554	53,279,981
Consumer	25,044,988	23,663,230
Other	248,774	304,536
	<u>\$ 245,457,095</u>	<u>\$ 217,834,276</u>

The changes in the allowance for loan losses are as follows for the years ended December 31, 2008 and 2007:

	<u>2008</u>	<u>2007</u>
Balance, January 1,	\$ 3,860,924	\$ 3,896,182
Provision for loan losses	405,000	250,000
Recoveries	137,182	185,779
Charge-offs	(931,252)	(471,037)
Balance, December 31,	<u>\$ 3,471,854</u>	<u>\$ 3,860,924</u>

Impaired loans consist of the following at December 31, 2008 and 2007:

	<u>2008</u>	<u>2007</u>
Impaired loans for which allowances for loan losses have been provided	\$ 360,392	\$ 372,983
Impaired loans for which allowances for loan losses have not been provided	2,307,570	2,924,176
Recorded investment in impaired loans	<u>\$ 2,667,962</u>	<u>\$ 3,297,159</u>
Allowance for loan losses provided for impaired loans	<u>\$ 147,000</u>	<u>\$ 214,000</u>

At December 31, 2008 and 2007, the total recorded investment in loans on nonaccrual amounted to \$2,667,962 and \$3,175,270, respectively. There were no loans past due ninety days or more and still accruing interest at December 31, 2008 and 2007. The average recorded investment in impaired loans was \$3,142,158 and \$2,693,781 in 2008 and 2007, respectively. Interest income recognized for cash payments received on impaired loans was \$115,239 and \$175,191 in 2008 and 2007, respectively. There are no commitments to loan additional funds to the borrowers of impaired loans.

NOTE 5 – LAND, PREMISES AND EQUIPMENT

Land, premises and equipment, net consist of the following at December 31, 2008 and 2007:

	<u>2008</u>	<u>2007</u>
Land	\$ 1,742,841	\$ 1,742,841
Buildings	9,366,563	9,673,359
Furniture and equipment	4,035,815	4,434,275
Leasehold improvements	427,315	427,315
Construction in progress	–	3,868
	<u>15,572,534</u>	<u>16,281,658</u>
Less accumulated depreciation	<u>(4,397,631)</u>	<u>(4,753,926)</u>
	<u>\$ 11,174,903</u>	<u>\$ 11,527,732</u>

NOTE 5 – LAND, PREMISES AND EQUIPMENT *continued*

At December 31, 2008, the Bank leased four of its branch facilities under noncancelable operating leases. Future minimum rental payments under these leases are as follows:

2009	\$ 116,651
2010	38,144
2011	26,401
2012	11,001
2013	1
Thereafter	42
	<u>\$ 192,240</u>

Rent expense under the operating leases totaled \$144,470 and \$173,911 in 2008 and 2007, respectively.

At December 31, 2008, the Bank leased out space under noncancelable operating leases. Future minimum rental payments to be received by the Company under these leases are as follows:

2009	\$ 83,236
2010	85,317
2011	87,450
2012	89,636
2013	91,877
Thereafter	191,434
	<u>\$ 628,950</u>

Rent income under the operating leases totaled \$80,858 and \$77,891 in 2008 and 2007, respectively.

NOTE 6 – DEPOSITS

Certificates of deposit in denominations of \$100,000 and over were \$67,885,506 and \$80,147,839 at December 31, 2008 and 2007, respectively.

At December 31, 2008, scheduled maturities of time deposits are as follows:

2009	\$ 140,336,547
2010	3,815,238
2011	4,252,353
2012	215,180
2013	61,726
	<u>\$ 148,681,044</u>

NOTE 7 – SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

Information concerning securities sold under agreements to repurchase as of and for the years ended December 31 is summarized as follows:

	<u>2008</u>	<u>2007</u>
Average balance	\$ 6,567,845	\$ 6,341,966
Maximum month-end balance	\$ 9,025,127	\$ 8,172,459
Carrying amounts of securities, including accrued interest, underlying the agreements	\$ 8,757,283	\$ 6,740,317

Securities sold under agreements to repurchase mature in less than ninety days from the transaction date. Securities sold under agreements to repurchase either remain under the control of the Bank or are held in third party custodial accounts that recognize the Bank's interest in the securities.

NOTE 8 – BORROWINGS

Borrowings consist of an overnight line of credit and a one month overnight repricing line of credit with the Federal Home Loan Bank of New York (FHLB) which expire on July 31, 2009. Each line has a maximum borrowing limit of \$39,363,300 at December 31, 2008. Amounts available on the lines may also be used for term advances. The term advance of \$1,000,000 outstanding at December 31, 2008 and 2007 was not issued under either of the lines. At December 31, 2008 the overnight line has an available balance of \$31,363,300 and the one month overnight line has an available balance of \$39,363,300. The Bank's investment in FHLB stock and other assets, primarily mortgage loans, are pledged as collateral under the agreement up to the amount of any borrowings. The Bank has the following advances from the Federal Home Loan Bank at December 31, 2008:

Term advance due April 27, 2011, bearing interest at 4.76%	\$ 1,000,000
Overnight advance, bearing interest at 0.44%	<u>8,000,000</u>
	<u>\$ 9,000,000</u>

Advances under the lines totaled \$1,000,000 at December 31, 2007.

The Company, through the Bank, had available unsecured line of credit agreements with correspondent banks permitting borrowings to a maximum of \$10.0 million at December 31, 2008 and \$5.0 million at December 31, 2007. There were no outstanding advances against those lines at December 31, 2008 or 2007.

NOTE 9 – JUNIOR SUBORDINATED DEBENTURES

On June 27, 2003, the Company issued \$1,035,000 in junior subordinated debentures due June 27, 2033, to Trust I. The Company owns all of the \$35,000 in common equity of Trust I and the debentures are the sole asset of Trust I. Trust I issued \$1,000,000 of floating-rate trust capital securities in a non-public offering. The floating-rate capital securities provide for quarterly distributions at a variable annual coupon rate, reset quarterly, based on three-month LIBOR plus 2.75%. The coupon rate was 4.218% at December 31, 2008, and 7.58% at December 31, 2007. The securities are callable by the Company, subject to any required regulatory approval, at par, after five years.

The Company unconditionally guarantees the Trust I capital securities. The terms of the junior subordinated debentures and the common equity of Trust I mirror the terms of the trust capital securities issued by the Trust I. The Company used the net proceeds from this offering to fund an additional \$1,000,000 capital investment in the Bank to fund its operations and future growth.

On August 23, 2004, the Company issued \$5,155,000 in junior subordinated debentures due August 23, 2034, to Trust II. The Company owns all of the \$155,000 in common equity of Trust II and the debentures are the sole asset of Trust II. Trust II issued \$5,000,000 of floating-rate trust capital securities in a non-public offering. The floating-rate capital securities provide for quarterly distributions at variable coupon rate, reset quarterly, based on three-month LIBOR plus 2.65%. The coupon rate was 4.803% at December 31, 2008 and 7.665% at December 31, 2007. The securities are callable by the Company subject to any required regulatory approval, at par, after five years.

The Company unconditionally guarantees the Trust II capital securities. The terms of the junior subordinated debentures and the common equity of Trust II mirror the terms of the trust capital securities issued by Trust II. The Company used the net proceeds from this offering to fund an additional \$5,000,000 capital investment in the Bank to fund its operations and future growth.

NOTE 9 – JUNIOR SUBORDINATED DEBENTURES *continued*

In accordance with FASB Interpretation No. 46, "Consolidation of Variable Interest Entities," the accounts of Trust I and Trust II are not included in the consolidated financial statements of the Company. However, for regulatory purposes, the trust capital securities qualify as Tier I capital of the Company subject to a 25% of capital limitation under risk-based capital guidelines. The portion that exceeds the 25% of capital limitation qualifies as Tier II capital. At December 31, 2008 and 2007, \$6,000,000 in trust capital securities qualified as Tier I capital.

NOTE 10 – INCOME TAXES

The provision for income taxes consists of the following for the years ended December 31:

	<u>2008</u>	<u>2007</u>
Current tax provision:		
Federal	\$ 1,107,321	\$ 868,729
State	500	500
	<u>1,107,821</u>	<u>869,229</u>
Deferred tax benefit	(175,821)	(336,079)
	<u>\$ 932,000</u>	<u>\$ 533,150</u>

The provision for income taxes differs from that computed by applying statutory rates to income before income taxes primarily due to the effects of tax exempt income from investment securities and bank owned life insurance.

Net deferred tax assets included in other assets in the accompanying consolidated balance sheets are as follows:

	<u>2008</u>	<u>2007</u>
Deferred tax assets	\$ 2,918,627	\$ 2,242,001
Deferred tax liabilities	(1,158,118)	(580,947)
Net deferred tax assets	<u>\$ 1,760,509</u>	<u>\$ 1,661,054</u>

Management believes it is more likely than not that all of the deferred tax assets will be realized. The amount of the deferred tax asset considered realizable, however, could be reduced in the near term if estimates of future taxable income are reduced.

NOTE 11 – STOCKHOLDERS' EQUITY

The common stock and treasury stock of the Company at December 31, 2008 and 2007 are as follows:

	<u>2008</u>	<u>2007</u>
Common stock, authorized shares, \$0.50 par value	<u>2,000,000</u>	<u>2,000,000</u>
Issued shares	867,664	867,664
Less: treasury stock shares	(21,021)	(13,450)
Outstanding shares	<u>846,643</u>	<u>854,214</u>

Total comprehensive income is reported in the accompanying consolidated statements of stockholders' equity. Information related to net other comprehensive income is as follows:

	<u>2008</u>	<u>2007</u>
Other comprehensive income:		
Securities available for sale:		
Changes in net unrealized gains during the year	\$ 1,732,487	\$ 525,231
Reclassification adjustment for gains included in income	(71,255)	(19,630)
Pension and postretirement benefits:		
Amortization of prior service costs	930	744
Net actuarial loss	(1,471,246)	232,241
	<u>190,916</u>	<u>738,586</u>
Tax expense	(76,366)	(295,433)
Total Other Comprehensive Income	<u>\$ 114,550</u>	<u>\$ 443,153</u>

The components of accumulated other comprehensive loss, net of tax, as of December 31 were as follows:

	<u>2008</u>	<u>2007</u>
Net unfunded liability for pension and postretirement benefit plans	\$ (1,016,875)	\$ (134,686)
Net unrealized gain on securities available for sale	<u>1,004,054</u>	<u>7,315</u>
Accumulated Other Comprehensive Loss	<u>\$ (12,821)</u>	<u>\$ (127,371)</u>

NOTE 12 – PENSION AND POSTRETIREMENT BENEFIT PLANS

The Company adopted SFAS No. 158 "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106, and 132R" effective December 31, 2006, which required the recognition of the funded status of its defined benefit pension and postretirement benefit plans as either assets or liabilities on the consolidated balance sheet. Future changes in the funded status of the defined benefit pension and postretirement plans will be recognized in the year in which the changes occur on a net tax basis through accumulated other comprehensive income or loss.

SFAS No. 158 also required the measurement date for plan assets and liabilities to coincide with the Company's consolidated balance sheet date, effective for fiscal years ending after December 15, 2008. As the Company had historically measured the defined benefit pension plan as of October 1, the incremental, or transition pension cost recognized as a result of this change in measurement date was recognized as an adjustment to retained earnings in 2008 in accordance with SFAS No. 158.

NOTE 12 – PENSION AND POSTRETIREMENT BENEFIT PLANS *continued*

The following table presents the components of accumulated other comprehensive loss, net of taxes, related to SFAS No. 158 as of December 31:

	Defined Pension Plan	Post- retirement Benefit Plan	Total
2008			
Prior service cost (credit)	\$ 4,740	\$ (28,810)	\$ (24,070)
Net actuarial loss	975,391	65,554	1,040,945
Total	\$ 980,131	\$ 36,744	\$ 1,016,875
2007			
Prior service cost	\$ 5,298	\$ –	\$ 5,298
Net actuarial loss	4,230	125,158	129,388
Total	\$ 9,528	\$ 125,158	\$ 134,686

The estimated costs that will be amortized from accumulated other comprehensive loss into net periodic cost during 2009 are as follows:

	Defined Pension Plan	Post- retirement Benefit Plan	Total
Prior service cost (credit)	\$ 744	\$ (3,852)	\$ (3,108)
Net actuarial loss	85,262	5,263	90,525
Total	\$ 86,006	\$ 1,411	\$ 87,417

Defined Benefit Pension Plan

The Company participates in the New York State Bankers Retirement System, a non-contributory defined benefit pension plan (the “Plan”) covering substantially all employees. The benefits are based on years of service and the employee’s highest average compensation during five consecutive years of employment.

The following table provides a reconciliation of the changes in the Plan’s benefit obligations and fair value of assets for the years ending December 31, 2008 and 2007:

	2008	2007
Change in Benefit Obligation:		
Benefit obligation at beginning of year	\$ 2,939,086	\$ 2,606,803
Service cost	372,659	298,730
Interest cost	225,611	166,110
Actuarial loss	352,038	28,939
Expenses	(655)	–
Benefits paid	(204,879)	(161,496)
Benefit obligation at end of year	3,683,860	2,939,086
Change in Plan assets:		
Fair value of plan assets at beginning of year	3,571,632	3,247,060
Actual return on Plan assets	(937,184)	486,068
Employer contribution	–	–
Benefits paid	(204,879)	(161,496)
Fair value of Plan assets at end of year	2,429,569	3,571,632
Funded status recognized	\$ (1,254,291)	\$ 632,546
Accumulated benefit obligation	\$ 3,140,399	\$ 2,369,931

The components of net periodic pension cost are as follows:

	<u>2008</u>	SFAS No. 158 Transition	<u>2007</u>
Service cost	\$ 298,127	\$ 74,532	\$ 298,730
Interest cost	180,489	45,122	166,110
Expected return on Plan assets	(264,028)	(30,428)	(239,685)
Amortization of prior service cost	744	186	744
	<u>\$ 215,332</u>	<u>\$ 89,412</u>	<u>\$ 225,899</u>

During 2008, net periodic pension cost totaled \$304,744. Of this, \$215,332 was recognized in earnings. The transition amount of \$89,412 represents the impact of adopting the measurement date provision of SFAS No. 158 and has been included in retained earnings, net of income taxes.

The actuarial assumptions used to determine the accumulated benefit obligation are as follows as of December 31:

	<u>2008</u>	<u>2007</u>
Discount rate	6.00%	6.25%
Rate of compensation increase	2.50%	3.50%

The actuarial assumptions used to determine net periodic pension cost are as follows for the years ended December 31:

	<u>2008</u>	<u>2007</u>
Discount rate	6.25%	6.50%
Expected long-term rate of return on Plan assets	7.00%	7.50%
Rate of compensation increase	3.50%	3.50%

The discount rate used for each period was based upon the rates of return on high-quality fixed income investments. The objective of using this approach is to measure the single amount that, if invested at the measurement date in a portfolio of high-quality debt instruments, would provide the necessary future cash flows to pay benefits when they became due. The discount rates are evaluated at each measurement date to give effect to changes in the general level of interest rates.

The expected long-term rate-of-return on Plan assets reflects long-term earnings expectations on each asset class in the Plan as well as target asset allocations. In estimating that rate, appropriate consideration was given to historical returns earned by Plan assets and the rates of return expected to be available for reinvestment. Average rates of return over the past 1, 3, 5 and 10 year periods were determined and subsequently adjusted to reflect current capital market assumptions and changes in investment allocations.

The Company's funding policy is to contribute, at a minimum, an actuarially determined amount that will satisfy the minimum funding requirements determined under the appropriate sections of the Internal Revenue Code. Based on the current determinations, the Company expects to contribute \$400,000 to the Plan during 2009.

NOTE 12 – PENSION AND POSTRETIREMENT BENEFIT PLANS *continued*

Estimated future benefit payments, which reflect expected future service, as appropriate, are as follows:

2009	\$ 120,831
2010	\$ 124,116
2011	\$ 129,660
2012	\$ 147,536
2013	\$ 180,075
2014 - 2018	\$ 1,363,079

The Plan's weighted-average asset allocations by asset category are as follows:

	2008	2007
Equity securities	55%	58%
Debt securities	41	40
Other	4	2
Total	<u>100%</u>	<u>100%</u>

The Plan was established in 1938 to provide for the payment of benefits to employees of participating banks. The Plan is overseen by a Board of Trustees who meet quarterly and set the investment policy guidelines.

The Plan utilizes two investment management firms (which will be referred to as Firm I and Firm II), each investing approximately 68% and 32% of the total portfolio, respectively. The Plan'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 Trustees and designed to achieve an allocation approximating 60% invested in equity securities and 40% invested in debt securities.

Each Firm shall report at least quarterly to the Investment Committee and semi-annually to the Board.

The target allocation percentage for equity securities is 60% but may vary from 50% - 70% at the investment manager's discretion.

Firm I is employed for its expertise as a value manager. It is allowed to invest a certain amount of the equity portfolio under its management in international securities and to hedge said international securities so as to protect against currency devaluations.

The equities managed by Firm II are in a commingled Large Cap Equity Fund. The Portfolio is permitted to invest in a diversified range of securities in the U.S. Equity Markets. Although the portfolio holds primarily common stocks, from time to time the portfolio may invest in other types of investments on an opportunistic basis.

For both investment portfolios, the target allocation percentage for debt securities is 40% but may vary from 30% to 50% at the investment manager's discretion.

The Fixed Income Portfolio managed by Firm I operates within guidelines relating to types of debt securities, quality ratings, maturities, and maximum single and sector allocations.

The Fixed Income managed by Firm II is a Core Bond Fixed Income Fund. The portfolio investments are limited to US Dollar denominated, fixed income securities and selective derivatives designed to have similar attributes of such fixed income securities. The term "fixed income security" is

defined to include instruments with fixed, floating, variable, adjustable, auction-rate, zero or other coupon features.

Postretirement Benefit Plan

The Company has an unfunded postretirement health insurance plan for certain employees meeting eligibility requirements.

The postretirement benefit plan's accumulated postretirement benefit obligation included in other liabilities totaled \$410,191 and \$561,384 at December 31, 2008 and 2007, respectively. Benefits paid totaled \$35,199 and \$40,641 for the years ended December 31, 2008 and 2007, respectively. Total net periodic benefit cost recorded was approximately \$36,000 and \$66,000 for the years ended December 31, 2008 and 2007, respectively.

The following benefits are expected to be paid over the next 10 years:

2009	\$	33,451
2010	\$	33,179
2011	\$	32,880
2012	\$	32,550
2013	\$	34,454
2014 - 2018	\$	165,143

The assumed health care cost trend rate used in the postretirement benefit plan at December 31, 2008 was 4.00%. Assumed health care trend rates may have a significant effect on the amounts reported for this plan. A 1% increase in the trend rate would increase the periodic benefit cost by \$3,401 and increase the accumulated postretirement benefit obligation by \$43,944.

Defined Contribution Plan

The Bank has a contributory 401(k) Plan for substantially all employees. Employees are eligible to contribute a percentage of their salary up to the maximum as determined by the Internal Revenue Service. The Bank is required to match 75% of the employees' contributions up to a maximum of 6% of the employees' salaries. The Bank contributed \$198,331 and \$173,314 under these provisions during 2008 and 2007, respectively.

Deferred Compensation Plans

Prior to 2007, the Company had entered into employment agreements with key executives. These employment agreements established deferred compensation plans whereby Company stock was awarded and vested each year. In 2007, the Company terminated the employment agreements and related deferred compensation plans and established new deferred compensation plans for key executives. The new plans require a vesting period of three years. Awarded shares from both the prior plan and the current plan are restricted from being sold until employment is terminated.

The Company obtains shares for the new deferred compensation plan either through open market purchases or from treasury shares. The amount of awarded shares is based on the amount paid to each executive under the deferred compensation plan. The amount paid is then used to obtain deferred compensation shares. The price paid for the shares from treasury is the average daily closing price of the stock for each day within the past quarter. Total deferred compensation shares were 21,919 and 18,375 at December 31, 2008 and 2007, respectively. Total shares awarded were 3,544 and 2,717 for 2008 and 2007, respectively, while total unvested shares were 1,587 and 1,275 at December 31, 2008 and 2007, respectively. Compensation expense is recognized over the vesting period, and is based upon the total amount paid to obtain shares for each executive. Compensation expense related to these plans was approximately \$62,000 and \$87,000 for the years ended December 31, 2008 and 2007, respectively.

NOTE 13 – SERVICE CHARGES AND FEES

Service charges and fees consisted of the following for the years ended December 31, 2008 and 2007:

	<u>2008</u>	<u>2007</u>
Service charges and fees on deposit accounts	\$ 1,676,327	\$ 1,765,451
ATM fees	496,869	449,926
Loan commitment fees	240,861	167,767
Credit card and merchant fees	47,034	44,793
Service charges on loans	127,096	98,728
Loan servicing income	183,227	205,402
Insurance and brokerage fees	444,420	590,265
Other	16,446	18,333
	<u>\$ 3,232,280</u>	<u>\$ 3,340,665</u>

NOTE 14 – RELATED PARTY TRANSACTIONS

In the ordinary course of business, the Bank has and expects to continue to have transactions, including loans and deposit accounts with the Company's and the Bank's executive officers and directors and their affiliates. In the opinion of management, such transactions were on substantially the same terms, including interest rates and collateral, as those prevailing at the time of comparable transactions with other persons and did not involve more than a normal risk of collectibility or present any other unfavorable features. The aggregate amount of loans to such related parties at December 31, 2008 and 2007 was \$7,032,233 and \$5,349,464, respectively. During 2008, new loans to such related parties amounted to \$2,687,788 and repayments amounted to \$1,005,019.

The Bank held deposits of \$2,432,743 and \$2,261,239 for related parties at December 31, 2008 and 2007, respectively.

The Bank has an operating lease with one of its directors. Under the terms of the lease, the Bank receives monthly payments of \$3,569 through August 2009, increasing 2.5% per year thereafter, until August 2010.

NOTE 15 – COMMITMENTS AND CONTINGENT LIABILITIES

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the consolidated balance sheets. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments. The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual notional amount of those instruments summarized as follows at December 31:

	<u>2008</u>	<u>2007</u>
Commitments to extend credit:		
Commitments to grant loans	\$ 27,544,539	\$ 12,228,327
Unfunded commitments under commercial lines of credit	32,496,883	36,616,732
Unfunded commitments under consumer lines of credit	26,100,569	20,618,702
Standby letters of credit	8,339,895	6,774,118
	<u>\$ 94,481,886</u>	<u>\$ 76,237,879</u>

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. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount and type of collateral obtained, if deemed necessary by the Bank upon extension of credit, varies and is based on management's credit evaluation of the counterparty.

Standby letters of credit are conditional lending commitments issued by the Bank to guarantee the performance of a customer to a third party. These letters of credit are primarily issued to support public and private borrowing arrangements. Generally, 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. The Bank's policy for obtaining collateral, and the nature of such collateral, is essentially the same as that involved in making commitments to extend credit. The Bank generally holds collateral supporting those commitments. Such collateral amounted to \$8,234,295 and \$6,689,443 at December 31, 2008 and 2007, respectively. The amount of the liability related to guarantees under standby letters of credit was not material at December 31, 2008 and 2007.

In addition to other investors, the Bank sells residential mortgage loans to the FHLB. The agreement with the FHLB includes a maximum credit enhancement liability of \$675,000 at both December 31, 2008 and 2007, which the Bank may be required to pay if realized losses on any of the sold mortgages exceed the amount held in the FHLB's spread account. The FHLB is funding the spread account annually based on the outstanding balance of loans sold. The Bank's historical losses on residential mortgages have been lower than the amount being funded to the spread account. As such, the Bank does not anticipate recognizing any losses and, accordingly, has not recorded a liability for the credit enhancement.

NOTE 16 – CONCENTRATIONS OF CREDIT

Most of the Bank's business activity is with customers in the Bank's market area. The majority of those customers are depositors of the Bank. Investments in state and local government securities also involve governmental entities within the Bank's market area. The concentrations of credit by type of loan are set forth in Note 4. The distribution of commitments to extend credit are set forth in Note 15. The Bank, as matter of policy, does not extend credit to any single borrower, or group of related borrowers in excess of its legal lending limit.

NOTE 17 – REGULATORY MATTERS

The Bank is subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

NOTE 17 – REGULATORY MATTERS *continued*

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined by regulation) and of Tier I capital (as defined) to average assets (as defined).

Effective November 21, 2005, the Bank entered into a formal written agreement (Agreement) with The Comptroller of the Currency (OCC) whereby the following capital levels must be maintained: Tier 1 leverage capital shall at least be equal to eight percent (8%) of average assets; Tier 1 risk-based capital shall at least be equal to ten percent (10%) of adjusted total assets; and total risk-based capital shall at least equal twelve percent (12%) of risk-weighted assets. The requirement in the Agreement to maintain a specific capital level meant that the Bank may not be deemed to be well capitalized under the regulatory framework for prompt corrective action.

In July 2008, after meeting all requirements outlined in the Agreement, the Agreement was terminated. The Bank is no longer subject to the capital requirements outlined in the Agreement.

Management believes, as of December 31, 2008, that the Bank meets all capital adequacy requirements to which it is subject.

As of the most recent notification from the OCC, the Bank was categorized as well capitalized. There are no conditions or events since the notification that management believes have changed the institution's category. The Bank's capital amounts and ratios are also presented in the table below.

	Actual		For Capital Adequacy Purposes		To be Well Capitalized under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2008						
Total capital (to risk-weighted assets)	\$ 36,536,000	13.6%	\$ ≥ 21,436,000	8.0%	\$ ≥ 26,795,000	10.0%
Tier I capital (to risk-weighted assets)	\$ 33,187,000	12.4%	\$ ≥ 10,718,000	4.0%	\$ ≥ 16,077,000	6.0%
Tier I capital (to average assets)	\$ 33,187,000	8.3%	\$ ≥ 15,952,000	4.0%	\$ ≥ 19,940,000	5.0%
December 31, 2007						
Total capital (to risk-weighted assets)	\$ 34,180,000	14.0%	\$ ≥ 29,265,000	12.0%*	\$ ≥ 29,265,000	12.0%*
Tier I capital (to risk-weighted assets)	\$ 31,132,000	12.8%	\$ ≥ 24,388,000	10.0%*	\$ ≥ 24,388,000	10.0%*
Tier I capital (to average assets)	\$ 31,132,000	8.2%	\$ ≥ 30,212,000	8.0%*	\$ ≥ 30,212,000	8.0%*

* Required levels per the Agreement

NOTE 18 – FAIR VALUE MEASUREMENTS AND FAIR VALUES OF FINANCIAL INSTRUMENTS

Management uses its best judgment in estimating the fair value of the Company's financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily indicative of the amounts the Company could have realized in a sales transaction on the dates indicated. The estimated fair value amounts have been measured as of December 31, 2008 and 2007 and have not been re-evaluated or updated for purposes of these financial statements subsequent to December 31, 2008 and 2007. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at those dates.

In September 2006, the 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 year beginning January 1, 2007.

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. FSP 157-3 is effective immediately and applies to the Company's December 31, 2008 consolidated financial statements. The adoption of SFAS 157 and FSP 157-3 had no impact on the amounts reported in the Company's 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.

Level 2: Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability.

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported with little or no market activity).

An asset's or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

For financial assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at December 31, 2008 and 2007 are as follows:

Description	Carrying Value	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
December 31, 2008				
Securities available for sale	<u>\$ 128,858,315</u>	<u>\$ 23,901,647</u>	<u>\$ 104,607,490</u>	<u>\$ 349,178</u>
December 31, 2007				
Trading securities	\$ 19,799,146	\$ 19,799,146	\$ —	\$ —
Securities available for sale	<u>\$ 91,806,801</u>	<u>\$ —</u>	<u>\$ 91,806,801</u>	<u>\$ —</u>

The following table presents a reconciliation of the securities available for sale measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the year ended December 31:

	2008
Beginning balance, January 1	\$ —
Purchases	102,825
Transfers into Level 3 during the year	<u>246,353</u>
Ending balance, December 31	<u>\$ 349,178</u>

NOTE 18 – FAIR VALUE MEASUREMENTS AND FAIR VALUES OF FINANCIAL INSTRUMENTS *continued*

For financial assets measured at fair value on a nonrecurring basis, the fair value measurements by level within the fair value hierarchy used at December 31, 2008 and 2007 are as follows:

Description	Carrying Value	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
December 31, 2008				
Impaired loans	\$ 213,392	\$ –	\$ –	\$ 213,392
December 31, 2007				
Impaired loans	\$ 158,983	\$ –	\$ –	\$ 158,983

The following information should not be interpreted as an estimate of the fair value of the entire Company since a fair value calculation is only provided for a limited portion of the Company's assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Company's disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair values of the Company's financial instruments at December 31, 2008 and 2007:

Cash, Due From Banks, Federal Funds Sold, Interest-bearing Deposits in Banks

The carrying amounts reported in the consolidated balance sheets for these assets approximate those assets' fair values.

Investment Securities

Fair values for trading securities are based on quoted market prices. The fair value of securities available for sale and held to maturity are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1), or matrix pricing (Level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted prices. For certain securities which are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence (Level 3). In the absence of such evidence, management's best estimate is used. Management's best estimate consists of external support on certain Level 3 investments. Management has determined that the fair value of local government securities in the held to maturity portfolio approximate their carrying value. Restricted equity securities have restrictions on their sale and are carried at cost due to their limited marketability.

Loans Held for Sale

The fair value of loans held for sale is determined using quoted secondary-market prices. If no such quoted prices exist, the fair value of a loan is determined using quoted prices for a similar loan or loans, adjusted for the specific attributes of that loan.

Loans

The fair values of loans are estimated using discounted cash flow analyses, using market rates at the balance sheet date that reflect the credit and interest rate-risk inherent in the loans. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments and prepayments of principal. Generally, for variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values.

Impaired Loans

Impaired loans are those that are accounted for under FASB Statement No. 114, "Accounting by Creditors for Impairment of a Loan" ("SFAS 114"), in which the Bank has measured impairment generally based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements. The fair value consists of the loan balance of \$360,392 and \$372,983, net of a valuation allowance of \$147,000 and \$214,000 as of December 31, 2008 and 2007, respectively.

Accrued Interest Receivable and Payable

The carrying amount of accrued interest receivable and accrued interest payable approximates its fair value.

Mortgage Servicing Rights

The carrying amount of mortgage servicing rights approximates their fair value.

Deposits

The fair values disclosed for demand and savings deposits are, by definition, equal to their carrying amounts. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered in the market on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Securities Sold Under Agreements to Repurchase

The carrying amounts of securities sold under agreements to repurchase approximate their fair values.

Borrowings from the Federal Home Loan Bank

Fair values of borrowings from the FHLB are estimated using discounted cash flow analysis, based on quoted prices for new borrowings from the FHLB with similar credit risk characteristics, terms and remaining maturity. These prices obtained from this active market represent a market value that is deemed to represent the transfer price if the liability were assumed by a third party.

Junior Subordinated Debentures

The fair values of junior subordinated debentures are estimated using discounted cash flow analysis, based on market rates currently offered on such debt with similar credit risk characteristics, terms and remaining maturity.

NOTE 18 – FAIR VALUE MEASUREMENTS AND FAIR VALUES OF FINANCIAL INSTRUMENTS *continued*

Off-Balance Sheet Financial Instruments

Fair values for off-balance sheet financial instruments (lending commitments and letters of credit) are based on fees currently charged in the market to enter into similar agreements, taking into account, the remaining terms of the agreements and the counterparties' credit standing.

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

	2008		2007	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash and due from banks	\$ 9,423,539	\$ 9,423,539	\$ 13,092,059	\$ 13,092,059
Federal funds sold	168,964	168,964	16,915,292	16,915,292
Interest bearing deposits in banks	2,429,317	2,429,317	490,768	490,768
Trading securities	–	–	19,799,146	19,799,146
Investment securities	134,451,400	134,451,400	96,486,368	96,486,368
Loans, net of allowance	241,985,241	245,855,000	213,973,352	219,853,000
Accrued interest receivable	1,857,107	1,857,107	2,059,124	2,059,124
Mortgage servicing rights	138,796	138,796	126,341	126,341
Financial liabilities:				
Deposits	356,766,992	358,434,000	342,729,529	345,783,000
Securities sold under agreements to repurchase	8,642,295	8,642,295	6,489,099	6,489,099
Borrowings	9,000,000	9,001,000	1,000,000	996,000
Junior subordinated debentures	6,190,000	3,334,815	6,190,000	5,679,697
Accrued interest payable	371,142	371,142	559,414	559,414

Amounts in the preceding table are included in the consolidated balance sheets under the applicable captions. The fair values of off-balance sheet financial instruments are not significant.

NOTE 19 – SEGMENT INFORMATION

The Company has two reportable segments, the Bank and LRAC. The Bank provides traditional commercial banking services to both individuals and businesses. LRAC is a real estate investment trust that holds only real estate mortgages. All other activity, including Lyons Bancorp, Inc.'s activities, is considered banking. The accounting policies of the segments are the same as those described in Note 1.

The Company's reportable segments are strategic business units. They are managed separately because each segment has an impact on the Company's income tax expense based on amounts distributed from LRAC to the Bank.

Segment information for 2008 and 2007 is as follows (in thousands):

	Bank	LRAC	Eliminations	Consolidated Totals
2008				
Interest income	\$ 19,091	\$ 1,722	\$ (25)	\$ 20,788
Interest expense	7,310	–	(25)	7,285
Net Interest Income	11,781	1,722	–	13,503
Provision for loan losses	405	–	–	405
Non-interest income	3,927	41	(69)	3,899
Non-interest expense	12,980	71	(69)	12,982
Income before Taxes	2,323	1,692	–	4,015
Minority interest	–	5	–	5
Income tax expense	932	–	–	932
Net Income	\$ 1,391	\$ 1,687	\$ –	\$ 3,078
Assets	\$ 414,965	\$ 35,552	\$ (39,027)	\$ 411,490
Loans, net	210,210	31,775	–	241,985
Deposits	359,555	–	(2,788)	356,767
Equity	26,544	35,490	(35,490)	26,544
Depreciation expense	778	–	–	778
2007				
Interest income	\$ 20,510	\$ 1,501	\$ (12)	\$ 21,999
Interest expense	9,471	–	(12)	9,459
Net Interest Income	11,039	1,501	–	12,540
Provision for loan losses	250	–	–	250
Non-interest income	3,684	38	(57)	3,665
Non-interest expense	12,791	67	(57)	12,801
Income before Taxes	1,682	1,472	–	3,154
Minority interest	–	5	–	5
Income tax expense	533	–	–	533
Net Income	\$ 1,149	\$ 1,467	\$ –	\$ 2,616
Assets	\$ 386,546	\$ 25,263	\$ (27,404)	\$ 384,405
Loans, net	190,908	23,065	–	213,973
Deposits	344,530	–	(1,800)	342,730
Equity	24,625	25,202	(25,202)	24,625
Depreciation expense	761	–	–	761

PROFILE

Lyons Bancorp, Inc. is a bank holding company headquartered in Lyons, New York, with assets of \$411 million at December 31, 2008. Lyons Bancorp, Inc. has one banking subsidiary, The Lyons National Bank.

The Lyons National Bank is a community bank with offices in Clyde, Lyons, Macedon, Newark, Ontario and Wolcott in Wayne County, Jordan in Onondaga County, Geneva in Ontario County and Penn Yan in Yates County. Subsidiaries of The Lyons National Bank are Lyons Realty Associates Corp. and LNB Life Agency, Inc.

STOCK SYMBOL

LYBC

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Lyons Bancorp, Inc. &
The Lyons National Bank*

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*General Manager
Herrema's Market Place*

Clair J. Britt, Jr.

*Executive Vice President &
Senior Commercial Lending Officer
The Lyons National Bank*

Andrew F. Fredericksen, CPA

*Senior Partner
Fredericksen & Sirianni, LLP*

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Real Estate Broker

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