

Board of Governors of the Federal Reserve System
Washington, D.C. 20551

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2009

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE EXCHANGE ACT OF 1934

For the transition period from _____ to _____

BANK OF MCKENNEY

(Exact name of registrant as specified in its charter)

Virginia

54-0132540

(State or other jurisdiction of incorporation or organization)

(IRS employer identification no.)

20718 First Street

McKenney, Virginia

23872

(Address of principal executive offices)

(Zip Code)

(804) 478-4434

(Registrant's telephone number, including area code)

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

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such reports).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated Filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act)

Yes No

SEC 1296 (02-08) **Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.**

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the last practical date.

1,926,656 shares of Common Stock, par value \$2.00 per share (August 10, 2009)

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

BANK OF MCKENNEY AND SUBSIDIARY
Consolidated Balance Sheets
June 30, 2009 (unaudited) and December 31, 2008

ASSETS	June 30, 2009	December 31, 2008
Cash and due from banks	\$ 6,083,596	\$ 6,847,451
Federal funds sold	908,000	858,000
Interest-bearing time balances in other banks	-	1,540,252
Securities available for sale, at fair market value	26,075,430	28,998,239
Securities held to maturity, at current book value	3,925,529	956,448
Restricted investments	794,725	789,525
Loans:		
Commercial	8,123,521	7,922,920
Commercial Real Estate	52,060,764	48,625,651
Real Estate Construction	11,897,301	9,833,256
Residential Real Estate	43,597,653	43,046,066
Consumer	2,302,075	2,355,887
Loans, gross	\$ 117,981,314	\$ 111,783,780
Less allowance for loan losses	(1,386,338)	(1,135,000)
Loans, net	\$ 116,594,976	\$ 110,648,780
Land, premises and equipment, net	8,075,732	8,185,167
Other real estate owned	414,135	-
Accrued interest receivable	842,448	897,883
Bank owned life insurance	3,193,022	3,127,712
Other assets	2,535,241	2,612,367
Total Assets	\$ 169,442,834	\$ 165,461,824
LIABILITIES		
Deposits:		
Noninterest-bearing deposits	\$ 24,812,726	\$ 26,141,215
Savings and interest bearing demand deposits	36,196,303	34,959,275
Time deposits	85,355,605	81,792,333
Total deposits	\$ 146,364,634	\$ 142,892,823
Federal Home Loan Bank advances	3,166,667	3,333,333
Accrued interest payable	307,727	324,396
Accrued expenses and other liabilities	1,217,566	1,543,650
Total Liabilities	\$ 151,054,594	\$ 148,094,202
Commitments and contingencies	\$ -	\$ -
SHAREHOLDERS' EQUITY		
Common stock, \$2 par value, authorized 2,250,000 shares issued and outstanding 1,926,656 shares	\$ 3,853,312	\$ 3,853,312
Surplus	5,893,958	5,893,958
Retained earnings	9,511,770	8,972,226
Accumulated other comprehensive loss	(870,800)	(1,351,874)
Total shareholders' equity	\$ 18,388,240	\$ 17,367,622
Total Liabilities and Shareholders' Equity	\$ 169,442,834	\$ 165,461,824

See Notes to Unaudited Consolidated Financial Statements

BANK OF MCKENNEY AND SUBSIDIARY

Consolidated Statements of Income

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Interest and Dividend Income:				
Interest and fees on loans	\$ 1,994,589	\$ 2,057,923	\$ 4,011,193	\$ 4,182,652
Interest and dividends on securities - taxable	374,718	351,220	763,295	649,691
Interest on securities - nontaxable	41,756	38,917	80,673	72,781
Interest on federal funds sold	1,436	36,747	2,703	85,901
Interest on deposits with other institutions	114	16,533	5,164	30,275
Total interest and dividend income	<u>\$ 2,412,613</u>	<u>\$ 2,501,340</u>	<u>\$ 4,863,028</u>	<u>\$ 5,021,300</u>
Interest Expense:				
Money market and NOW accounts	\$ 52,715	\$ 66,215	\$ 111,974	\$ 118,615
Savings	14,727	17,951	28,505	35,895
Time	645,175	813,055	1,318,501	1,655,488
Federal funds purchased	--	--	109	--
Federal Home Loan Bank advances	38,400	154,489	77,354	314,605
Total interest expense	<u>\$ 751,017</u>	<u>\$ 1,051,710</u>	<u>\$ 1,536,443</u>	<u>\$ 2,124,603</u>
Net interest income	\$ 1,661,596	\$ 1,449,630	\$ 3,326,585	\$ 2,896,697
Provision for loan losses	163,000	130,000	323,000	160,000
Net interest income after provision for loan losses	<u>\$ 1,498,596</u>	<u>\$ 1,319,630</u>	<u>\$ 3,003,585</u>	<u>\$ 2,736,697</u>
Noninterest income:				
Service charges on deposit accounts	\$ 227,195	\$ 216,953	\$ 436,373	\$ 421,381
Secondary market origination fees	132,411	117,482	226,709	244,873
Net gain on sale of securities	40,117	226,666	39,736	250,472
Bank-owned Life Insurance	31,879	31,023	65,309	62,430
Other operating income	69,946	40,368	129,633	88,244
Gain on sale of other real estate owned	--	--	--	9,579
Total noninterest income	<u>\$ 501,548</u>	<u>\$ 632,492</u>	<u>\$ 897,760</u>	<u>\$ 1,076,979</u>
Noninterest expense:				
Salaries and employee benefits	\$ 943,596	\$ 913,551	\$ 1,862,858	\$ 1,815,949
Occupancy expense	101,539	88,826	205,662	183,864
Furniture and equipment expense	123,881	117,917	236,223	229,194
Data processing	63,299	59,846	92,897	104,120
Telecommunications	38,213	36,075	74,772	69,283
Stationery and supplies	28,324	22,498	52,480	46,102
Audit and accounting fees	47,796	46,682	93,042	91,740
FDIC assessment fees	101,171	15,958	125,391	19,472
Corporate franchise tax	30,154	30,875	60,308	61,750
Other operating expenses	174,642	177,782	358,732	339,270
Total noninterest expense	<u>\$ 1,652,615</u>	<u>\$ 1,510,010</u>	<u>\$ 3,162,365</u>	<u>\$ 2,960,744</u>
Net income before taxes	\$ 347,529	\$ 442,112	\$ 738,980	\$ 852,932
Income taxes	86,319	122,415	199,436	239,031
Net income	<u>\$ 261,210</u>	<u>\$ 319,697</u>	<u>\$ 539,544</u>	<u>\$ 613,901</u>
Net income per common share, basic and diluted	<u>\$ 0.14</u>	<u>\$ 0.17</u>	<u>\$ 0.28</u>	<u>\$ 0.32</u>

See Notes to Unaudited Consolidated Financial Statements

BANK OF MCKENNEY AND SUBSIDIARY
Consolidated Statements of Changes in Shareholders' Equity
For the Six Months Ended June 30, 2009 and 2008
(unaudited)

	<u>Common Stock</u>	<u>Surplus</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Comprehensive Income</u>	<u>Total</u>
Balance at December 31, 2007	\$ 3,853,312	\$ 5,893,958	\$ 8,240,118	\$ 81,313		\$ 18,068,701
Comprehensive income:						
Net income	-	-	613,901	-	\$ 613,901	613,901
Other comprehensive loss:						
Unrealized holding losses on securities available for sale arising during the period, net of tax benefit of \$134,258	-	-	-	-	(260,619)	-
Less reclassification adjustment, net of tax of (\$85,161)	-	-	-	-	(165,312)	-
Other comprehensive loss, net of tax				(425,931)	\$ (425,931)	(425,931)
Total comprehensive income					<u>\$ 187,970</u>	
Balance at June 30, 2008	<u>\$ 3,853,312</u>	<u>\$ 5,893,958</u>	<u>\$ 8,854,019</u>	<u>\$ (344,618)</u>		<u>\$ 18,256,671</u>
Balance at December 31, 2008	\$ 3,853,312	\$ 5,893,958	\$ 8,972,226	\$ (1,351,874)		\$ 17,367,622
Comprehensive income:						
Net income	-	-	539,544	-	\$ 539,544	539,544
Other comprehensive income:						
Unrealized holding gains on securities available for sale arising during the period, net of tax of \$261,336	-	-	-	-	507,300	-
Less reclassification adjustment, net of tax of (\$13,510)	-	-	-	-	(26,226)	-
Other comprehensive income, net of tax				481,074	\$ 481,074	481,074
Total comprehensive income					<u>\$ 1,020,618</u>	
Balance at June 30, 2009	<u>\$ 3,853,312</u>	<u>\$ 5,893,958</u>	<u>\$ 9,511,770</u>	<u>\$ (870,800)</u>	261,336	<u>\$ 18,388,240</u>

BANK OF MCKENNEY AND SUBSIDIARY

Consolidated Statements of Cash Flows

For the Six Months Ended June 30, 2009 and 2008

(unaudited)

	2009	2008
Cash Flows from Operating Activities		
Net income	\$ 539,544	\$ 613,901
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	246,177	248,529
Provision for loan losses	323,000	160,000
Increase in cash surrender value of life insurance	(65,310)	(62,430)
Net gain on sales of securities available for sale	(39,736)	(250,472)
Net gain on sales of other real estate owned	-	(9,579)
Net amortization (accretion) of premiums (discounts) on securities	(41,521)	(45,133)
Changes in assets and liabilities:		
(Increase) Decrease in accrued interest receivable	55,435	(121,398)
Increase in other assets	(170,698)	(7,805)
Decrease in accrued interest payable	(16,669)	(33,512)
Increase in accrued expenses and other liabilities	192,113	4,076
Net cash provided by operating activities	\$ 1,022,335	\$ 496,177
Cash flows from Investing Activities		
Net change in interest-bearing deposits in banks	\$ 1,540,252	\$ (3,000,000)
Activity in available for sale securities:		
Sales	2,051,365	7,227,306
Maturities, prepayments and calls	3,632,002	13,847,389
Purchases	(4,919,483)	(24,639,487)
(Purchase) redemption of restricted securities (FHLB stock)	(5,200)	299,500
Net increase in loans	(6,684,196)	(2,740,204)
Purchase of land, premises and equipment	(135,877)	(247,162)
Proceeds from sale of other real estate owned	-	144,579
Net cash used in investing activities	\$ (4,521,137)	\$ (9,108,079)
Cash Flows from Financing Activities		
Net increase in deposits	\$ 3,471,811	\$ 10,099,963
Dividend distributions	(520,197)	(520,197)
Repayment of long-term debt	(166,667)	(6,166,667)
Net cash provided by financing activities	\$ 2,784,947	\$ 3,413,099
Net decrease in cash and cash equivalents	\$ (713,855)	\$ (5,198,803)
Cash and Cash Equivalents		
Beginning of year	7,705,451	11,223,898
End of Year	\$ 6,991,596	\$ 6,025,095
Supplemental Disclosures of Cash Flow Information		
Cash paid during the year for:		
Interest	\$ 1,553,112	\$ 2,158,113
Income Taxes	\$ 286,037	\$ 235,600
Supplemental Disclosures of Noncash Investing and Financing Activities		
Fair value adjustment for securities	\$ 728,899	\$ (645,347)
Transfer between loans and other real estate owned	\$ 415,000	\$ 135,000

See Notes to Unaudited Consolidated Financial Statements

Notes to Unaudited Consolidated Financial Statements

1. General

Bank of McKenney (the “Bank”) offers a full range of banking and financial services to individuals, professionals, and small and medium sized businesses through six full service banking offices in the counties of Dinwiddie, southern Chesterfield and Prince George and the city of Colonial Heights. The Bank is subject to competition from other financial institutions. The Bank is also subject to the regulations of the Board of Governors of the Federal Reserve System and the State Corporation Commission of Virginia, and it undergoes periodic examinations by these regulatory authorities.

McKenney Group, L.L.C. (the “Subsidiary”) is a wholly-owned subsidiary of the Bank. McKenney Group, L.L.C. was formed in December of 2000 to provide networking solutions to Virginia community banks. The Subsidiary maintains the partial ownership interests previously acquired by McKenney Title, Inc.

The accompanying consolidated financial statements of Bank of McKenney and its subsidiary collectively have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. They do not include all of the information and notes required by accounting principles generally accepted in the United States of America for complete financial statements. Therefore, these consolidated statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Bank of McKenney Annual Report on Form 10-K for the year ended December 31, 2008. All significant intercompany balances and transactions have been eliminated. In the opinion of management, the accompanying consolidated financial statements contain all adjustments and reclassifications consistent with those of a normal and recurring nature considered necessary to present fairly the financial position as of June 30, 2009 and December 31, 2008 and the results of operations for the three and six month periods ended June 30, 2009 and 2008 and changes in shareholders’ equity and cash flows for the six months ended June 30, 2009 and 2008. Operating results for the three and six-month periods ended June 30, 2009 and 2008 are not necessarily indicative of full year financial results.

Certain prior year amounts have been reclassified to conform to the current year’s method of presentation.

2. Investment Securities

The following table sets forth a summary of the amortized cost and fair market value of investment securities at June 30, 2009 and December 31, 2008:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized (Losses)</u>	<u>Fair Market Value</u>
June 30, 2009				
Available for sale				
U.S. government agencies	\$ 10,700,818	\$ 84,953	\$ -	\$ 10,785,771
Obligations of state and political subdivisions	6,213,337	80,556	(27,954)	6,265,939
Corporate debt securities	10,480,669	23,086	(1,480,035)	9,023,720
	<u>\$ 27,394,824</u>	<u>\$ 188,595</u>	<u>\$ (1,507,989)</u>	<u>\$ 26,075,430</u>
Held to maturity				
Corporate securities	<u>\$ 3,925,529</u>	<u>\$ 116,639</u>	<u>\$ (9,569)</u>	<u>\$ 4,032,599</u>
December 31, 2008				
Available for sale				
U.S. government agencies	\$ 12,200,503	\$ 195,850	\$ -	\$ 12,396,353
Mortgage-backed securities	1,199,432	26,125	-	1,225,557
Obligations of state and political subdivisions	4,234,377	27,213	(58,438)	4,203,152
Corporate debt securities	13,412,221	69,250	(2,308,294)	11,173,177
	<u>\$ 31,046,533</u>	<u>\$ 318,438</u>	<u>\$ (2,366,732)</u>	<u>\$ 28,998,239</u>
Held to maturity				
Corporate securities	<u>\$ 956,448</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 956,448</u>

The contractual maturities of investment securities classified as available for sale (“AFS”) and held to maturity (“HTM”) at June 30, 2009 are shown below. Expected maturities may differ from contractual maturities because mortgages underlying the mortgage-backed securities may be called or prepaid without any penalties.

	<u>Available for sale</u>		<u>Held to maturity</u>	
	<u>Amortized Cost</u>	<u>Fair Value</u>	<u>Amortized Cost</u>	<u>Fair Value</u>
Debt securities				
Maturing within one year	\$ 2,120,938	\$ 2,145,571	\$ -	\$ -
Maturing after one year, but within five years	10,597,590	9,971,256	3,925,529	4,032,599
Maturing after five years, but within ten years	12,834,497	12,107,233	-	-
Maturing after ten years	1,841,799	1,851,370	-	-
Total	<u>\$ 27,394,824</u>	<u>\$ 26,075,430</u>	<u>\$ 3,925,529</u>	<u>\$ 4,032,599</u>

Due to volatility in the prices of certain debt securities, future investments in non-government issued investment grade debt will likely be categorized as HTM and carried at amortized cost until maturity. The Bank has the ability and intent to hold all purchases to maturity; however, AFS has historically been chosen to provide for maximum liquidity. The Bank has numerous other means of liquidity and foresees no concern over this election during this low point in the economy. As of June 30, 2009, three issues had been so classified. One issue was so classified as HTM on December 31, 2008.

There were no securities pledged to secure public deposits or for other purposes required by law at June 30, 2009. The Bank utilizes letters of credit through the Federal Home Loan Bank for meeting the collateral requirements of such deposits.

Due to certain banking relationships with the Federal Reserve Bank, the Federal Home Loan Bank and Community Bankers' Bank, the Bank has invested \$794,725 in restricted investments required by these entities. These investments are carried at cost, which approximates redemption value.

The Bank had securities in its portfolio at June 30, 2009 and December 31, 2008 that reflected an unrealized loss in value. These unrealized losses have been evaluated and are considered to be temporary impairments of the value of the issues. A summary of these securities as of June 30, 2009 and December 31, 2008 is as follows:

Description	June 30, 2009					
	Total		Less than 12 Months		12 Months or Greater	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Available for sale						
Corporate securities	\$ 8,496,880	\$ (1,480,035)	\$ -	\$ -	\$ 8,496,880	\$ (1,480,035)
Tax exempt municipals	2,105,593	(27,954)	1,064,529	(16,423)	1,041,064	(11,531)
Unrealized Loss Positions	\$ 10,602,473	\$ (1,507,989)	\$ 1,064,529	\$ (16,423)	\$ 9,537,944	\$ (1,491,566)
Held to maturity						
Corporate securities	\$ 1,453,019	\$ (9,569)	\$ -	\$ -	\$ 1,453,019	\$ (9,569)
December 31, 2008						
Description	Total		Less than 12 Months		12 Months or Greater	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Corporate securities	\$ 7,650,677	\$ (2,308,294)	\$ 7,650,677	\$ (2,308,294)	\$ -	\$ -
Tax exempt municipals	1,864,924	(58,438)	1,456,136	(49,577)	408,788	(8,861)
Unrealized Loss Positions	\$ 9,515,601	\$ (2,366,732)	\$ 9,106,813	\$ (2,357,871)	\$ 408,788	\$ (8,861)

Management evaluates securities for other-than-temporary impairments at least on a quarterly basis and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the intent of the Bank to sell the security, (2) whether it is more likely than not that the Bank will be required to sell the security before recovery of its amortized cost basis, and (3) whether the Bank expects to recover the securities entire amortized cost basis regardless of the Bank's intent to sell the security.

At June 30, 2009, the securities identified above with unrealized losses consisted of seven corporate issues, and eight issues of different municipalities. The corporate credits are all investment grade placements within the financial services industry which have been significantly affected by the turmoil in credit markets and accompanying global economic slowdowns over the past two years. This market condition, resulting from concerns over the effects the housing bubble collapse is having on the creditworthiness in loan and investment portfolios of financials, has resulted in demand for such debt to fall significantly, leading to violent swings in market prices. In response, the federal government established the Troubled Asset Relief Program ("TARP") to support financial institutions, and all of the current holdings are eligible for participation in this program or have received other direct government support. With the corporate issuances being investment grade, eligible for government assistance and unrealized losses precipitated by a market circumstance rather than individual debt worthiness, these unrealized losses are currently believed temporary with no permanent impairment expected. All municipal bonds' unrealized losses reflect changes in the prevailing interest rate environments as well as the issues' maturities. No principal is expected to be lost, and the unrealized losses, primarily due to interest rates, are considered temporary in nature.

The Corporation's investment in Federal Home loan Bank ("FHLB") stock totaled \$447,900 at June 30, 2009. FHLB stock is generally viewed as a long term investment and as a restricted investments security which is carried at cost, because there is no market for the stock other than the FHLB's or member institutions. Therefore, when evaluating FHLB stock for impairment, its value is based on ultimate recoverability of the par value rather than by recognizing temporary declines in value. Despite the FHLB's temporary suspension of cash dividend payments and repurchases of excess capital stock in 2009, the Corporation does not consider this investment to be other temporarily impaired at June 30, 2009 and no impairment has been recognized.

In analyzing an issuer's financial condition, management considers whether the federal government or its agencies issued the securities, whether downgrades by bond rating agencies have occurred, and industry analysts' reports. As management has the ability and intent to hold debt securities until maturity, or for the foreseeable future if classified as available for sale, no declines are deemed to be other than temporary.

3. Allowance for Loan Losses

The following represents an analysis of changes in the allowance for loan losses for the three months ended June 30, 2009 and 2008:

	June 30,	
	2009	2008
Balance, beginning of period	\$ 1,135,000	\$ 925,000
Provision for loan losses	323,000	160,000
Charge-offs	(80,819)	(152,570)
Recoveries of loans previously charged off	9,157	24,095
Balance, end of period	<u>\$ 1,386,338</u>	<u>\$ 956,525</u>
Allowance for loan losses to total loans	<u>1.18%</u>	<u>0.88%</u>

The following is a summary of information pertaining to impaired loans at June 30, 2009 and December 31, 2008:

	June 30, 2009	December 31, 2008
Impaired loans with a valuation allowance	\$ 2,834,425	\$ 1,570,055
Impaired loans without a valuation allowance	1,660,353	193,028
Other real estate owned	414,135	--
Total impaired loans	<u>\$ 4,908,913</u>	<u>\$ 1,763,083</u>
Valuation allowance related to impaired loans	<u>\$ 531,000</u>	<u>\$ 409,500</u>
Average investment in impaired loans	<u>\$ 4,090,515</u>	<u>\$ 1,448,309</u>
Interest income recognized	<u>\$ 227,596</u>	<u>\$ 108,988</u>

There were no non-accrual loans excluded from impaired loan disclosure under SFAS No. 114 at June 30, 2009 and December 31, 2008. At both June 30, 2009 and December 31, 2008 there were no loans past due in excess of ninety days and still accruing recorded.

4. Earnings Per Share

As the Bank does not currently offer stock options, there was no effect on income available to common shareholders. The following shows the weighted average number of shares used in computing earnings per share.

	Three Months Ended June 30,				Six Months Ended June 30,			
	2009		2008		2009		2008	
	Shares	Per Share	Shares	Per Share	Shares	Per Share	Shares	Per Share
Basic & Diluted earnings per share	1,926,656	\$ 0.14	1,926,656	\$ 0.17	1,926,656	\$ 0.28	1,926,656	\$ 0.32

5. Fair Value Measurements

The fair value of a financial instrument is the current amount that would be exchanged between willing parties, other than in a forced liquidation. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Bank's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. Therefore, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Bank.

The following methods and assumptions were used by the Bank to estimate fair value disclosures for financial instruments:

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

Interest-bearing deposits in banks: The carrying amounts of interest-bearing deposits maturing within 90 days approximate their fair values. Fair values of other interest-bearing deposits are estimated using discounted cash flow analyses based on current rates for similar deposit types.

Securities: Fair values for securities, excluding restricted investments, are based on quoted market prices. The carrying value of restricted investments approximates fair value based on the redemption provisions of the restricted investments.

Loans receivable: For variable-rate loans that re-price frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for certain mortgage loans (e.g., one-to-four family residential), credit card loans, and other consumer loans are based on quoted market prices of similar loans sold in conjunction with securitization transactions, adjusted for differences in loan characteristics. Fair values for other loans (e.g., commercial real estate and investment property mortgage loans, commercial and industrial loans) are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for non-performing loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

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

Borrowings: The fair values of the Bank's long-term borrowings are estimated using discounted cash flow analyses based on the Bank's current incremental borrowing rates for similar types of borrowing arrangements.

Accrued interest: The carrying amounts of accrued interest approximate fair values.

Off-balance-sheet instruments: The fair value of commitments to extend credit is estimated using the fees currently charged to enter similar agreements, taking into account the remaining terms of the agreements and the present credit worthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of standby letters of credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligations with the counterparties at the reporting date. At June 30, 2009 and December 31, 2008, fair values of loan commitments and standby letters of credit were immaterial; therefore, they have not been included in the table below.

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

	June 30, 2009		December 31, 2008	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(in thousands)			
Financial assets:				
Cash and cash equivalents	\$ 6,992	\$ 6,992	\$ 7,705	\$ 7,705
Interest bearing deposits in banks	-	-	1,540	1,540
Securities available-for-sale	27,387	26,075	28,998	28,998
Securities held-to-maturity	3,926	3,926	956	956
Restricted investments	795	795	790	790
Loans, net	116,595	120,834	110,649	119,119
Accrued interest receivable	842	842	898	898
Financial liabilities:				
Deposits	\$ 146,366	\$ 147,340	\$ 142,893	\$ 143,641
Borrowings	3,167	3,173	3,333	3,340
Accrued interest payable	308	308	324	324

SFAS No. 157, “Fair Value Measurements”, specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Bank's market assumptions. The three levels of the fair value hierarchy under SFAS 157 based on these two types of inputs are as follows:

Level 1 - Valuation is based on quoted prices in active markets for identical assets and liabilities.

Level 2 - Valuation is based on observable inputs including quoted prices in active markets for similar assets and liabilities, quoted prices for identical or similar assets and liabilities in less active markets, and model-based valuation techniques for which significant assumptions can be derived primarily from or corroborated by observable data in the market.

Level 3 - Valuation is based on model-based techniques using one or more significant inputs or assumptions that are unobservable in the market.

The following is a description of the valuation bases and methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy:

Recurring basis:

Securities available for sale: Securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, when available (Level 1). If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar securities for which significant assumptions are derived primarily from or corroborated by observable market data. Third party vendors compile prices from various sources and may determine the fair value of identical or similar securities by using pricing models that consider observable market data (Level 2).

The following table presents the balances of financial assets and liabilities measured at fair value on a recurring basis as of June 30, 2009:

Description	Balance as of June 30, 2009	Fair Value Measurements at June 30, 2009 Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Available-for-sale securities	\$ 26,075,430	\$ -	\$ 26,075,430	\$ -

Certain financial assets are measured at fair value on a nonrecurring basis in accordance with GAAP. Adjustments to the fair value of these assets usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets.

Non-recurring basis:

Impaired Loans: Loans are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts due according to the contractual terms of the loan agreement will not be collected. The measurement of loss associated with impaired loans can be based on either the observable market price of the loan or the fair value of the collateral. Fair value is measured based on the value of the collateral securing the loans. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable. The vast majority of the collateral is real estate. The value of real estate collateral is determined utilizing an income or market valuation approach based on an appraisal conducted by an independent, licensed appraiser outside of the Bank using observable market data (Level 2). However, if the collateral is a house or building in the process of construction or if an appraisal of the real estate property is over two years old, then the fair value is considered Level 3. The value of business equipment is based upon an outside appraisal if deemed significant, or the net book value on the applicable business' financial statements if not considered significant using observable market data. Likewise, values for inventory and accounts receivables collateral are based on financial statement balances or aging reports (Level 3). Impaired loans allocated to the Allowance for Loan Losses are measured at fair value on a nonrecurring basis. Any fair value adjustments are recorded in the period incurred as provision for loan losses on the Consolidated Statements of Income.

Other Real Estate Owned: Certain assets such as other real estate owned (OREO) are measured at fair value less cost to sell. We believe that the fair value component in its valuation follows the provisions of SFAS No. 157.

The following table summarizes the Bank's financial assets that were measured at fair value on a nonrecurring basis during the period.

<u>Description</u>	<u>Balance as of June 30, 2009</u>	<u>Carrying value at June 30, 2009</u>		
		<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
Assets:				
Impaired Loans	\$ 2,303,425	\$ -	\$ 1,801,543	\$ 501,882
Other Real Estate Owned	\$ 414,135	\$ -	\$ 414,135	\$ -

The Bank assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. As a result, the fair values of the Bank's financial instruments will change when interest rate levels change, and that change may be either favorable or unfavorable to the Bank. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk. However, borrowers with fixed rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates and maturities of assets and liabilities and attempts to minimize interest rate risk by adjusting terms of new loans and deposits and by investing in securities with terms that mitigate the Bank's overall interest rate risk.

Item 2. Management's Discussion and Analysis or Plan of Operation

The following discussion is intended to assist readers in understanding and evaluating the Bank's financial condition and results of operations. In conjunction with reviewing the following discussion, you should also read and review the unaudited June 2009 and 2008 financial statements and accompanying notes presented previously in this document. This analysis provides an overview of the significant changes that occurred during the periods presented.

This report may contain, in addition to historical information, various "forward looking statements" that represent our judgment concerning the future and are subject to risks and uncertainties that could cause our actual operating results and financial position to differ materially from those projected in the forward looking statements. These forward looking statements can be identified by the use of forward looking terminology, such as "may," "will," "expect," "anticipate," "estimate" or "continue" or comparable words. We caution that any such forward looking statements are further qualified by important factors that could cause our actual operating results and financial position to differ materially from the forward looking statements, including, without limitation, considerations described in connection with specific forward looking statements and other cautionary statements set forth in this report.

Critical Accounting Policies

The Bank's financial statements are prepared in accordance with accounting principles generally accepted in the United States ("GAAP"). The financial information contained within our statements is, to a significant extent, financial information that is based on measures of the financial effects of transactions and events that have already occurred. A variety of factors could affect the ultimate value that is obtained either when earning income, recognizing an expense, recovering an asset or relieving a liability. We use historical loss factors as one factor in determining the inherent loss that may be present in our loan portfolio. Actual losses could differ significantly from the historical factors that we use. In addition, GAAP itself may change from one previously acceptable method to another method. Although the economics of our transactions would be the same, the timing of events that would impact our transactions could change.

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

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the 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.

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, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependant.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank normally does not separately identify such loans for impairment disclosures.

In preparing consolidated financial statements in conformity with GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses.

Comparison of Financial Condition at June 30, 2009 and December 31, 2008

At the end of the second quarter, total assets were \$169.2 million, representing a \$3.7 million or 2.24% increase over the December 31, 2008 level of \$165.5 million. Total deposits amounted to \$146.4 million as of June 30, 2009, which represents a \$3.5 million or 2.45% increase from the \$142.9 million level as of December 31, 2008. On an annualized basis, deposits grew during the second quarter at a rate of 4.90%. During the same period, total loans expanded by 5.55% or \$6.2 million to the June 30, 2009 balance of \$118.0 million. Loans, on an annualized basis, grew at a rate of 11.09%. At June 30, 2009, the investment portfolio, including time deposits in other banks, was \$30.8 million, a 4.64% decrease in comparison to the December 31, 2008 \$32.3 million level. Overnight federal funds sold held steady at \$0.9 million on both June 30, 2009 and December 31, 2008. Cumulatively, earning assets grew \$4.7 million for the first two quarters or 6.48% on an annualized basis and represent 88.48% of total assets.

The allowance for loan losses was \$1,386,000 as of June 30, 2009, or 1.18% of loans outstanding, compared to \$1,135,000 as of December 31, 2008 or 1.02% of outstanding loans. Charges to the Reserve account for loan losses amounted to \$81,000 as of June 30, 2009 or 0.07% of average outstanding loans for 2009. For the first six months of 2008, charges to the reserve of \$152,000 were taken representing 0.12% of average loans outstanding for the period. Allocations to the reserve account of \$323,000 were provisioned for the six months of 2009 compared to provision allocations of \$160,000 for the same period of 2008.

The Bank continues to focus on delinquencies and nonperforming loans within the portfolio; however, delinquency and nonperforming ratios have risen to 0.95% and 4.16%, respectively. These ratios, at December 31, 2008, stood at 0.61% and 1.58%, respectively. While current economic conditions have resulted in increases in these categories, management continues to feel comfortable that losses will be minimized by collateral positions as well as the Bank's ability and willingness to work with the borrowers during the current cycle where possible. Moreover, continued provisions to reserves have raised the loan loss reserve to 1.18% of total loans, an increase of 16 basis points over that of December 31, 2008.

Comparison of Results of Operations for the Three Months Ended June 30, 2009 and 2008

For the three-month period ending June 30, 2009, net income amounted to \$261,000, an 18.44% decrease when compared to net income of \$320,000 for the same period in 2008. The decline in net income is primarily the result of increases to loan reserves, a decline in securities gains recognized, and soaring deposit insurance rates by the Federal Deposit Insurance Corporation ("FDIC"). Additional charges by the FDIC of a separate special one-time assessment were expensed during the second quarter as well, adding to the overhead costs that reduced earnings. Basic and diluted earnings per share of \$0.14 were reported for the three months ended June 30, 2009, \$0.03 less than those of the prior year's \$0.17 results for the same period. There were 1,926,656 weighted average shares outstanding during each of the two periods.

Net interest income. Net interest income increased \$212,000 or 14.62% to \$1,662,000 in the second quarter of 2009 from \$1,450,000 in the comparable period in 2008. Margins have significantly expanded during the last few quarters as the cost of funds for deposits has plummeted 98 basis points while yields on earning assets have only dropped a mere 8 basis points. This margin strength has offset much of the additional overhead costs mentioned above. Average loans during the second quarter of 2009, when compared to the same period in 2008, grew to \$114.5 million from \$109.0 million, an increase of 5.05%. The average investment portfolio declined \$1.8 million from a second quarter 2008 average balance of \$31.8 million to a \$30.0 million average during the second quarter of 2009, or a decrease of 5.66%. Average deposit balances have increased 9.53% or \$12.7 million from the June 30, 2008 level of \$133.3 million to an average 2009 June 30, 2009 level of \$146.0 million. Time deposits experienced solid growth climbing 8.96% or \$6.9 million when comparing the two periods. Other interest bearing deposits experienced the strongest expansion with an increase of \$4.4 million or 13.79% while non-interest bearing deposits grew 5.74% or \$1.4 million when comparing June 30, 2009 to June 30, 2008. The Bank's prime based loan portfolio yields decreased 64 basis points when comparing the second quarter of 2009 to that period in 2008 while the investment portfolio in the same periods gained 127 basis points. Cumulatively, yields on earning assets decreased only 8 basis points from a 2008 second-quarter average of 6.80% to an average of 6.72% for the current year's second quarter. On the liability side of the balance sheet, the cost of funds plummeted to 2.51% for the second quarter of 2009 representing a decrease of 98 basis points below the second quarter 2008 level of 3.49%. Despite volume growth in the Bank's interest bearing deposit products during the second quarter of 2009, the substantially lower funding costs boosted the net interest margin by 66 basis points to 4.60% when comparing it to the 3.94% margin recorded for the second quarter period of 2008.

Noninterest income. Noninterest income, exclusive of securities transactions, climbed 13.55% or \$55,000 in the second quarter of 2009 to \$461,000 when compared to \$406,000 for the same period in 2008. Service charges posted slightly higher results with a \$10,000 or 4.61% increase when comparing the second quarter of 2009 to the second quarter of 2008. Lower mortgage rates in the second quarter again enticed the appetite of borrowers as the mortgage originations department experienced a \$15,000 or 12.82% gain in the category for the second quarter of 2009 when compared to the same period of 2008. Other noninterest products and services, including those of the insurance and investment departments, increased by \$31,000 over the \$71,000 level recorded in the second quarter of 2008.

Noninterest expense. Noninterest expense increased \$143,000 or 9.47% to \$1,653,000 during the second quarter 2009 from \$1,510,000 for the same period in 2008. Salaries and benefits rose 3.28% or \$30,000 while occupancy and furniture & equipment expenses increased \$19,000 or 9.03%. Other operating expenses for the second quarter of 2009 grew \$95,000 or 24.42% to a level of \$484,000. This increase is primarily the result of \$85,000 in additional FDIC costs during the quarter.

Provision for loan losses. Provisions for loan losses amounted to \$163,000 for the quarter ended June 30, 2009 as growth in delinquencies and nonperforming assets have risen above normal levels. Provisions for loan losses of \$130,000 were made during the second quarter of 2008.

Comparison of Results of Operations for the Six Months Ended June 30, 2009 and 2008

For the six-month period ending June 30, 2009, net income amounted to \$540,000 a 12.05% decrease when compared to net income of \$614,000 for the same period in 2008. Basic and diluted earnings per share of \$0.28 were reported for the six months ended June 30, 2009, \$0.04 less than those of the prior year's \$0.32 results for the same period. There were 1,926,656 weighted average shares outstanding during each of the two periods. Annualized returns on average assets and average equity for the first six months of 2009 were 0.65% and 6.17%, respectively, compared to 0.74% and 6.66%, respectively, for the same period in 2008.

Net interest income. Net interest income increased \$430,000 or 14.84% to \$3,327,000 in the first half of 2009 from \$2,897,000 in the comparable period in 2008. Margins have significantly expanded during the last few quarters as the cost of funds for deposits has plummeted 98 basis points while yields on earning assets have only dropped a mere 8 basis points. This margin strength has offset much of the additional overhead costs.

Noninterest income. Noninterest income, exclusive of securities transactions, climbed 3.75% or \$31,000 through the first two quarters of 2009 to \$858,000 when compared to \$827,000 for the same period in 2008. Service charges posted slightly higher results with a \$15,000 or 3.56% increase when comparing the first six months of 2009 to the first six months of 2008. Though second quarter results greatly improved, the mortgage originations department experienced a \$17,000 or 7.35% drop in revenues for the first two quarters of 2009 when compared to the same period of 2008. Other noninterest products and services, including those of the insurance and investment departments, increased by \$35,000 over the \$160,000 level recorded in the first half of 2008 to a 2009 level of \$195,000 for the same period.

Noninterest expense. Noninterest expense increased \$201,000 or 6.79% to \$3,162,000 during the first half of 2009 from \$2,961,000 for the same period in 2008. Salaries and benefits rose 2.59% or \$47,000 while occupancy and furniture & equipment expenses increased \$29,000 or 7.02%. Other operating expenses for the first two quarters of 2009 grew \$125,000 or 17.08% to a level of \$857,000. This increase is primarily the result of \$106,000 in additional FDIC costs during the period.

Provision for loan losses. Provisions for loan losses amounted to \$323,000 for the first half of 2009 as growth in delinquencies and nonperforming assets have risen above normal levels. Provisions for loan losses of \$160,000 were made during the same period in of 2008.

The following table illustrates average balances of total interest earning assets and total interest bearing liabilities for the periods indicated, showing the average distribution of assets, liabilities, shareholders' equity and related income, expense and corresponding weighted average yields and rates. The average balances used in these tables and other statistical data were calculated using daily average balances.

Average Balances, Interest Income and Expense and Average Yields and Rates

	Period Ended June 30,					
	2009			2008		
	Average Balance	Income / Expense	Yield / ⁽⁴⁾ Rate	Average Balance	Income / Expense	Yield / ⁽⁴⁾ Rate
(Dollars in Thousands)						
Assets:						
Interest earning assets:						
Investment securities ⁽¹⁾	\$ 29,988	\$ 897	5.98%	\$ 31,819	\$ 750	4.71%
Interest-bearing balances with banks	272	5	3.71%	1,298	22	3.41%
Loans	114,477	4,011	7.07%	109,012	4,182	7.71%
Federal funds sold	2,879	3	0.21%	7,087	94	2.67%
Total interest earning assets	<u>147,616</u>	<u>4,916</u>	<u>6.72%</u>	<u>149,216</u>	<u>5,048</u>	<u>6.80%</u>
Non-interest earning assets:						
Cash and due from banks	7,322			4,756		
Premises and equipment	8,125			8,310		
Other assets	6,716			5,631		
Less: Allowance for loan losses	(1,290)			(961)		
	<u>20,873</u>			<u>17,736</u>		
	<u>\$ 168,489</u>			<u>\$ 166,952</u>		
Liabilities and Stockholders' Equity						
Interest bearing liabilities:						
Interest-bearing demand deposits	\$ 16,725	\$ 74	0.89%	\$ 13,201	\$ 73	1.11%
Money market deposit accounts	8,055	38	0.95%	6,725	46	1.38%
Savings accounts	11,528	29	0.51%	12,055	36	0.60%
Time deposits	83,921	1,318	3.17%	76,968	1,654	4.32%
Total interest-bearing deposits	<u>120,229</u>	<u>1,459</u>	<u>2.45%</u>	<u>108,949</u>	<u>1,809</u>	<u>3.34%</u>
Securities sold under repurchase agreements	34	0	0.59%	-	-	0.00%
FHLB Advances	3,257	77	4.77%	13,395	315	4.73%
Total interest-bearing liabilities	<u>123,520</u>	<u>1,536</u>	<u>2.51%</u>	<u>122,344</u>	<u>2,124</u>	<u>3.49%</u>
Non-interest bearing liabilities:						
Demand deposits	25,811			24,421		
Other liabilities	1,498			1,586		
Total liabilities	<u>150,829</u>			<u>148,351</u>		
Shareholders' Equity	17,660			18,601		
Total Liabilities & Shareholders' Equity	<u>\$ 168,489</u>			<u>\$ 166,952</u>		
Interest Spread ⁽²⁾			4.21%			3.31%
Net Interest Margin ⁽³⁾		<u>\$ 3,380</u>	4.60%		<u>\$ 2,924</u>	3.94%

⁽¹⁾ Income and yields are reported on tax equivalent basis assuming a federal tax rate of 34%.

⁽²⁾ Interest Spread is the average yield earned on earning assets, less the average rate incurred on interest bearing liabilities.

⁽³⁾ Net interest margin is net interest income, expressed as a percentage of average earning assets.

⁽⁴⁾ Yields and rates are annualized.

Liquidity and Capital

The liquidity ratio at June 30, 2009 fell to 25.27% compared to 27.35% reported as of December 31, 2008. The overall Asset/Liability strategy of the organization takes into account the need for the Bank to maintain adequate liquidity to fund asset growth and deposit runoff. The management of the Bank monitors the liquidity position daily in conjunction with the Federal Reserve position monitoring. The Bank has credit lines both secured and unsecured available from several correspondent banks. Additionally, the Bank may borrow funds from the Federal Home Loan Bank of Atlanta. The credit facilities are used in conjunction with the normal deposit strategies, which include pricing changes to increase deposits as necessary. The organization can sell or pledge investment securities to create additional liquidity for the Bank. From time to time the organization may sell or participate out loans to create additional liquidity as required.

The Bank's capital ratios exceed regulatory requirements. The following table presents these ratios for the periods ending June 30, 2009 and December 31, 2008:

	Risk Based Capital Analysis		
	June 30, 2009	December 31, 2008	
	(Dollars in Thousands)		
Tier 1 Capital:			
Common stock	\$ 3,853	\$ 3,853	
Capital surplus	5,894	5,894	
Retained earnings	8,641	7,621	
Reverse: Unrealized losses	871	1,351	
Total tier 1 capital	<u>19,259</u>	<u>18,719</u>	
Tier 2 Capital:			
Allowance for loan losses	<u>1,386</u>	<u>1,135</u>	
Tier 3 Capital:			
Deductions for investments in banking and finance subsidiaries	<u>(180)</u>	<u>(180)</u>	
Total Risk Based Capital	<u>\$ 20,465</u>	<u>\$ 19,674</u>	
Risk weighted assets	<u>\$ 138,266</u>	<u>\$ 130,354</u>	
Quarterly average assets	<u>\$ 169,652</u>	<u>\$ 165,210</u>	
	June 30, 2009	December 31, 2008	Regulatory Minimum
Capital Ratios:			
Tier 1 risk based capital ratio	13.93%	14.36%	4.00%
Total risk based capital ratio	14.80%	15.09%	8.00%
Leverage ratio	11.35%	11.33%	4.00%

Recent Accounting Pronouncements

In April 2009, the Financial Accounting Standards Board (FASB) issued FSP FAS 141(R)-1, “Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies.” FSP FAS 141(R)-1 amends and clarifies SFAS 141(R) to address application issues on initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. The FSP is effective for assets and liabilities arising from contingencies in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Bank does not expect the adoption of FSP FAS 141(R)-1 to have a material impact on its consolidated financial statements.

In April 2009, the FASB issued FSP FAS 157-4, “Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly.” FSP FAS 157-4 provides additional guidance for estimating fair value in accordance with SFAS 157 when the volume and level of activity for the asset or liability have significantly decreased. The FSP also includes guidance on identifying circumstances that indicate a transaction is not orderly. FSP FAS 157-4 is effective for interim and annual periods ending after June 15, 2009, and shall be applied prospectively. The Bank does not expect the adoption of FSP FAS 157-4 to have a material impact on its consolidated financial statements.

In April 2009, the FASB issued FSP FAS 107-1 and APB 28-1, “Interim Disclosures about Fair Value of Financial Instruments.” FSP FAS 107-1 and APB 28-1 amends SFAS No. 107, “Disclosures about Fair Value of Financial Instruments,” to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. In addition, the FSP amends APB Opinion No. 28, “Interim Financial Reporting,” to require those disclosures in summarized financial information at interim reporting periods. The FSP is effective for interim periods ending after June 15, 2009. The Bank does not expect the adoption of FSP FAS 107-1 and APB 28-1 to have a material impact on its consolidated financial statements.

In April 2009, the FASB issued FSP FAS 115-2 and FAS 124-2, “Recognition and Presentation of Other-Than-Temporary Impairments.” FSP FAS 115-2 and FAS 124-2 amends other-than-temporary impairment guidance for debt securities to make guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities. The FSP does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. FSP FAS 115-2 and FAS 124-2 is effective for interim and annual periods ending after June 15, 2009. The Bank does not expect the adoption of FSP FAS 115-2 and FAS 124-2 to have a material impact on its consolidated financial statements.

In April 2009, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 111 (SAB 111). SAB 111 amends and replaces SAB Topic 5.M. in the SAB Series entitled “Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities.” SAB 111 maintains the SEC Staff’s previous views related to equity securities and amends Topic 5.M. to exclude debt securities from its scope. The Bank does not expect the implementation of SAB 111 to have a material impact on its consolidated financial statements.

In May 2009, the FASB issued Statement of Financial Accounting Standards No. 165, “Subsequent Events.” SFAS 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS 165 is effective for interim and annual periods ending after June 15, 2009. The Bank does not expect the adoption of SFAS 165 to have a material impact on its consolidated financial statements.

In June 2009, the FASB issued Statement of Financial Accounting Standards No. 166, “Accounting for Transfers of Financial Assets – an amendment of FASB Statement No. 140.” SFAS 166 provides guidance to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor’s continuing involvement, if any, in transferred financial assets. SFAS 166 must be applied as of the beginning of the first annual reporting period that begins after November 15, 2009 and for interim periods within that first annual reporting period. Earlier application is prohibited. The Bank does not expect the adoption of SFAS 166 to have a material impact on its consolidated financial statements.

In June 2009, the FASB issued Statement of Financial Accounting Standards No. 167, “Amendments to FASB Interpretation No. 46(R).” SFAS 167 improves financial reporting by enterprises involved with variable interest entities. SFAS 167 will be effective as of the beginning of the first annual reporting period that begins after November 15, 2009 and for interim periods within that first annual reporting period. Earlier application is prohibited. The Bank does not expect the adoption of SFAS 167 to have a material impact on its consolidated financial statements.

In June 2009, the FASB issued Statement of Financial Accounting Standards No. 168, “The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles – a replacement of FASB Statement No. 162.” SFAS 168 establishes the FASB Accounting Standards Codification, which will become the source of authoritative U.S. generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the Securities and Exchange Commission under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. On the effective date, the Codification will supersede all then-existing non-SEC accounting and reporting standards. All other nongrandfathered non-SEC accounting literature not included in the Codification will become nonauthoritative. SFAS 168 is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Bank does not expect the adoption of SFAS 168 to have a material impact on its consolidated financial statements.

In June 2009, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 112 (SAB 112). SAB 112 revises or rescinds portions of the interpretative guidance included in the codification of SABs in order to make the interpretive guidance consistent with current U.S. GAAP. The Bank does not expect the adoption of SAB 112 to have a material impact on its consolidated financial statements.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Not Required for Small Reporting Companies

Item 4. Controls and Procedures

Disclosure Controls and Procedures

The Bank’s management, with the participation of the Bank’s Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Bank’s disclosure controls and procedures as of the end of the period covered by this report. Based on such evaluation, the Bank’s Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Bank’s disclosure controls and procedures are effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by the Bank in the reports that it files or furnishes under the Securities Exchange Act of 1934.

Management reviews and evaluates the design and effectiveness of the Bank’s disclosure controls and procedures on an ongoing basis, which may result in the discovery of deficiencies, and improves its controls and procedures over time, correcting any deficiencies, as needed, that may have been discovered.

Changes in Internal Control Over Financial Reporting

Management reviews and evaluates the design and effectiveness of the Bank's internal control over financial reporting on an ongoing basis, which may result in the discovery of deficiencies, some of which may be significant. Management changes its internal control over financial reporting as needed to maintain its effectiveness, correcting any deficiencies, as needed, in order to ensure the continued effectiveness of the Bank's internal control over financial reporting. There have not been any changes in the Bank's internal control over financial reporting during the second quarter of 2009 that have materially affected, or are reasonably likely to materially affect, the Bank's internal control over financial reporting.

For management's assessment of the Bank's internal control over financial reporting, refer to the Bank's 2008 Annual Report on Form 10-K, "Management's Report on Internal Control over Financial Reporting."

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

None

Item 2. Unregistered Sales of Equity Securities or Use of Proceeds

None

Item 3. Defaults Upon Senior Securities

Not applicable

Item 4. Submission of Matters to a Vote of Security Holders

At an annual meeting of the shareholders of Bank of McKenney which was properly convened at 3:00 p.m. on May 12, 2009 in the boardroom of the corporate headquarters, the following two matters, and results thereto, were submitted to a vote:

1. The election of the following Directors to serve for one year and until their successors have been duly elected, have qualified, and have taken office yielded the following results:

	<u>For</u>	<u>Against</u>	<u>Withheld</u>
W. D. Allen III	1,515,272	0	3,913
Harry D. Baird III	1,432,492	0	86,693
Lewis J. Blaha, Jr.	1,511,421	0	7,764
Joan D. Clarke	1,515,272	0	3,913
L. M. Harrison, Jr.	1,506,561	0	12,624
Rudy L. Hawkins	1,511,761	0	7,424
Richard M. Liles	1,515,632	0	3,553
Joseph W. Lyle	1,515,632	0	3,553
Edward B. Titmus	1,512,121	0	7,064

2. The ratification of "Yount, Hyde, & Barbour, P.C." as the accounting firm to perform Bank of McKenney's independent audit for the year ending December 31, 2009 passed by the following vote tally.

<u>For</u>	<u>Against</u>	<u>Abstain</u>
1,507,270	2,323	9,592

Item 5. Other Information

(a) Required 8-K Disclosures

None

(b) Changes in Procedures for Director Nominations by Security Holders

None

Item 6. Exhibits

The following exhibits are filed as part of this Form 10-Q and this list includes the Exhibit Index:

<u>Exhibit Number</u>	<u>Description</u>	<u>Page</u>
3.1	Articles of Incorporation of Bank of McKenney	*
3.2	Amended and Restated Bylaws of Bank of McKenney	**
10.1	Employment Agreement, dated December 8, 1992, by and between Bank of McKenney and Richard M. Liles	*
10.2	Split-Dollar Life Insurance Agreement (as amended), dated February 1, 1989, by and between Bank of McKenney and Richard M. Liles	*
10.3	Deferred Compensation Agreement, dated February 1, 1989, between Bank of McKenney and Richard M. Liles	*
10.4	Deferred Compensation Agreement, dated February 1, 1993, between Bank of McKenney and Richard M. Liles	*
10.5	Form of Change in Control Employment Agreement, as amended, between Bank of McKenney and each of the following officers: James B. Neville, Jr., Lynda P. Cunningham, Mark H. Stevens.	***
10.6	Form of Change in Control Employment Agreement between Bank of McKenney and Michelle S. Fitch	***
21.1	Subsidiary - McKenney Group, LLC (a Virginia corporation)	*
31.1	CEO Section 302 Certification	†
31.2	CFO Section 302 Certification	†
32	Section 906 Certification	†

* Incorporated herein by reference from the Bank's Registration Statement on Form 10-SB, filed with the Board of Governors of the Federal Reserve System on September 9, 2002.

** Incorporated herein by reference from the Bank's report on Form 8-K filed with the Board of Governors of the Federal Reserve System on August 15, 2007.

*** Incorporated herein by reference from the Bank's Annual Report on Form 10-KSB for the year ended December 31, 2008, filed with the Board of Governors of the Federal Reserve System on March 10, 2009.

† Filed herewith.

SIGNATURES

In accordance with the requirements of the Exchange Act, the Bank has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

BANK OF MCKENNEY

Date: August 12, 2009

Richard M. Liles
President and Chief Executive Officer

Date: August 12, 2009

James B. Neville, Jr.
Executive Vice President and Chief Financial Officer

SECTION 302 CERTIFICATION

I, Richard M. Liles, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Bank of McKenney;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit any material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the small business issuer of, and for, the periods presented in this report;
4. The small business issuer's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the small business issuer and have:
 - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the small business issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) evaluated the effectiveness of the small business issuer's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) disclosed in this report any change in the small business issuer's internal control over financial reporting that occurred during the small business issuer's most recent fiscal quarter (the small business issuer's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the small business issuer's internal control over financial reporting; and
5. The small business issuer's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the small business issuer's auditors and the audit committee of the small business issuer's board of directors (or persons performing the equivalent functions):
 - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the small business issuer's ability to record, process, summarize and report financial information; and
 - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the small business issuer's internal control over financial reporting.

Date: August 12, 2009

Richard M. Liles
President and Chief Executive Officer

SECTION 302 CERTIFICATION

I, James B. Neville, Jr., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Bank of McKenney;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit any material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the small business issuer of, and for, the periods presented in this report;
4. The small business issuer's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the small business issuer and have:
 - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the small business issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) evaluated the effectiveness of the small business issuer's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) disclosed in this report any change in the small business issuer's internal control over financial reporting that occurred during the small business issuer's most recent fiscal quarter (the small business issuer's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the small business issuer's internal control over financial reporting; and
5. The small business issuer's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the small business issuer's auditors and the audit committee of the small business issuer's board of directors (or persons performing the equivalent functions):
 - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the small business issuer's ability to record, process, summarize and report financial information; and
 - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the small business issuer's internal control over financial reporting.

Date: August 12, 2009

James B. Neville, Jr.
Executive Vice President and Chief Financial Officer

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350 AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Bank of McKenney (the "Bank") on Form 10-Q for the period ending June 30, 2009 as filed with the Board of Governors of the Federal Reserve System on the date hereof (the "Report"), the undersigned Chief Executive Officer and Chief Financial officer of the Bank hereby certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002 that based on their knowledge and belief: 1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and 2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Bank as of and for the periods covered in the Report.

Richard M. Liles
President and Chief Executive Officer

James B. Neville, Jr.
Executive Vice President and Chief Financial Officer

Dated: August 12, 2009