

# 2008 ANNUAL REPORT



Mifflinburg  
Bancorp, Inc.

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# DIRECTORS, OFFICERS AND EMPLOYEES — MIFFLINBURG BANCORP, INC.

## 2008 OFFICERS

Wayne A. Bromfield, *Chairman of the Board*  
Thomas E. Boop, *Vice Chairman of the Board*  
Jeffrey J. Kapsar, *President and CEO*  
Robert K. Lynch, *Secretary*  
Thomas C. Graver, Jr., CPA, *Vice President, Chief Financial Officer and Treasurer*  
Thomas L. Eberhart, *Senior Vice President, Chief Operating Officer and Assistant Secretary*  
Andrea L. Long, *Assistant Vice President and Assistant Secretary*

## DIRECTORS EMERITUS

Helen P. Strunk, *Chairman Emeritus*  
David W. Diehl, *Director Emeritus*

## BOARD OF DIRECTORS

Thomas E. Boop  
Wayne A. Bromfield  
John D. Griffith  
Jeffrey J. Kapsar  
Robert K. Lynch  
Robert C. Musser  
W. Gale Reish  
D. Roger Shuck  
Robert E. Valentine

## MIFFLINBURG BANK AND TRUST COMPANY

### ADMINISTRATIVE SERVICES

Jeffrey J. Kapsar, *President and Chief Executive Officer*  
Jeffrey P. Reber, *Executive Vice President, Branch Administration*  
Thomas L. Eberhart, *Senior Vice President and Chief Operating Officer*  
Garry R. Benfer, *Senior Vice President of Loan Administration*  
Thomas C. Graver, Jr., CPA, *Vice President and Chief Financial Officer*  
Thomas E. Beck, CPA, *Vice President of Internal Audit and Compliance*  
Andrea L. Long, *Assistant Vice President of Human Resources*  
Linda A. Sprenkel, *Training and Marketing Coordinator*

### BOARD OF DIRECTORS

Thomas E. Boop  
Wayne A. Bromfield  
John D. Griffith  
Jeffrey J. Kapsar  
Robert K. Lynch  
Robert C. Musser  
W. Gale Reish  
D. Roger Shuck  
Robert E. Valentine

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### AUDIT

Britt E. Marten

### FINANCE

Leanne S. Belletti, *Controller*  
Lisa D. Hess

### TELLERS

Karen L. Kurtz, *Head Teller*  
Lynette K. Bechtol  
Jennifer L. Bingaman  
Stephanie V. Burnett  
Justina J. Confer  
Brenda L. Fye  
Julia A. Greenland  
Wendy E. Hufford  
Cheryl L. Kahl  
Nicole C. Kertis  
Cynthia L. Klose  
Janet M. Laubach  
Melissa M. Lynch  
Ashley V. Martin  
Monika N. Mironenko  
Janet M. Mueller  
Susan O. Pieters  
Judy E. Rishel  
Linda S. Rishel  
Sherry L. Ross  
Kimberly J. Scholl  
Sarah B. Sholley  
Linda L. Vonada  
Patricia A. Walter  
Natalie R. Winder  
Danette L. Zellers

### COMMUNITY OFFICE MANAGERS

Cynthia L. Foust  
Brian R. Derr  
Mandi L. Ruhl  
Kim H. Ranck  
Justin B. Troup

### LOAN OPERATIONS

Rebecca A. Bingaman  
*Loan Operations Manager*  
Carmen Harpster  
Donald W. Hepburn, Jr.  
Jeanette L. Leshar  
Michael E. Rogan  
Selena C.T. Shellenberger  
Lisa M. Sprenkle  
Joyce L. Tjaden

### CUSTOMER SERVICE REPRESENTATIVES

Casey L. Aukerman  
Donna L. Duke  
Fay A. Fausnaught  
Betsy J. Guffey  
Martha G. Hockenberry  
Beverly A. Merrick

### OPERATIONS

Lisa M. Hassinger  
*Electronic Banking Manager*  
Jerry A. Boyer, Jr., *Network Admin.*  
Lori L. Betz  
Susan M. Boop  
Janet M. Fry  
Kimberley A. Wagner

### LOAN OFFICERS

Clifford E. Valentine  
*Vice President-Commercial Services*  
William K. Greis  
Kris A. Ruhl  
Sandra L. Strickler  
Colleen M. Walter

### TELEPHONE SERVICE REPRESENTATIVES

Esther M. Dorman  
Heather C. Lowery  
Kelly A. Reiff

### FACILITIES/COURIER SERVICES

Terrence D. Gerlinski, *Facilities Mgr.*  
William A. Fluke, Sr.  
Lisa M. Culp  
Michael E. Kreisher

### TRUST/INVESTMENT SERVICES

Vicki L. Bailey, *Financial Consultant*  
Patti J. Zimmerman, *Trust Officer*  
Laurie J. Mast, *Assistant Trust Officer*

# LETTER FROM THE PRESIDENT

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Dear Shareholders:

The past year has been both challenging and unpredictable for everyone. The uncertainty in the economy and the volatility in the investment markets have proven to be very painful for many organizations. Fortunately, Mifflinburg Bank and Trust has continued the same safe and sound practices that have allowed us to remain a strong and profitable financial institution. Our assets consist of quality loans and government backed securities. We hold a small portfolio of stocks that does not include Fannie Mae or Freddie Mac stock. Additionally, we did not participate in sub-prime lending or invest in sub-prime mortgages. By maintaining sound banking principles, we were able to increase Earnings Per Share to \$3.10 in 2008 compared to \$3.00 in 2007.

Total assets grew 4.5% to \$276 million in 2008 from \$264 million in 2007. The majority of this growth was through wholesale funding with the Federal Home Loan Bank of Pittsburgh. Management identified a low cost funding source through this correspondent bank and increased borrowings from \$15.5 million to \$24.6 million. The borrowings were used to fund \$13.0 million in new loans. This strategy helped our Net Interest Margin grow to 3.59% in 2008 from 3.33% in 2007. Our Loan to Deposit ratio increased to 84.8% in 2008 from 79.2% in 2007 and our Loan to Asset ratio was 67.2% in 2008 versus 65.4% in 2007.

Net Income for 2008 increased to \$3,104,000 compared to \$3,008,000 in 2007. The increase in earnings was primarily driven by a 13.4% or \$1.1 million increase in our net interest income. This increase was offset through the funding of the Loan Loss Provision by \$259,000 and net securities losses of \$199,000. The Allowance for Loan Losses was increased due to loan growth and currently stands at 1.01% of total loans.

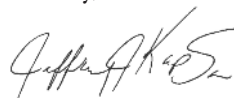
Achievements through 2008 began with the opening of our New Berlin office in early spring. In June, we purchased John Wilcox Lanes which is adjacent to our corporate headquarters. This facility is being renovated into a financial services center where we will manage trust, investment, and insurance customers. The Bank's operations center will also be located in the new facility, allowing us to expand our staff to provide the service needed to continue to grow in new markets. We also purchased a branch office in Shamokin Dam late in the year. We plan on relocating our current Hummels Wharf office to this more convenient and larger location. These strategic moves will give Mifflinburg Bank and Trust more visibility in the Susquehanna Valley as well as improving services to customers.

As stockholders you should know that Mifflinburg Bancorp, Inc. did not apply for any Troubled Asset Relief Program (TARP) funding. Your company is well capitalized with a Tier I Capital to Assets Ratio of 9.7%. By accepting TARP money, the Bank would be subject to restrictions that, in the opinion of management, would not be in the best interest of our stockholders.

Management did elect to continue participating in the Temporary Liquidity Guarantee Program. This program gives our customers FDIC insurance coverage over the stated \$250,000 for most of our transaction accounts. Although we consider the Bank to be safe and sound, we wanted to give our customers this additional peace of mind.

Looking ahead to the challenges and opportunities in 2009, we will continue to manage with the same conservative principles that have guided us through 137 years of business. We will remain a strong, competitive bank making prudent decisions that will continue our course of steady growth, profitability and longevity benefiting our customers, our stockholders and our community.

Sincerely,



Jeffrey J. Kapsar  
President & CEO



## **OUR VISION**

To Be Your Community's Trusted Financial Resource.

## **OUR MISSION STATEMENT**

We provide innovative solutions tailored to meet every customer's financial needs with dedicated employees who share in our company's success.

## **OUR VALUES**

Recognize and Respect the needs of others

Working together as one team

Commitment to our mission

Honesty, Integrity and Trust

Pride in ourselves and the organization

## **NOTICE OF ANNUAL SHAREHOLDERS MEETING OF MIFFLINBURG BANCORP, INC.**

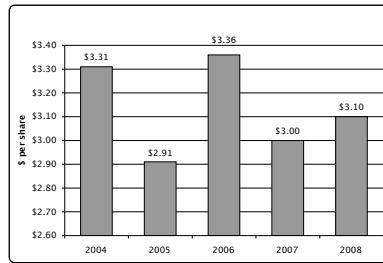
The Annual Shareholders Meeting of Mifflinburg Bancorp, Inc. is scheduled for  
10 a.m., April 29, 2009  
in the Retail Banking & Lending Center,  
250 East Chestnut Street, Mifflinburg, Pennsylvania.

## **THE BUSINESS OF MIFFLINBURG BANCORP, INC.**

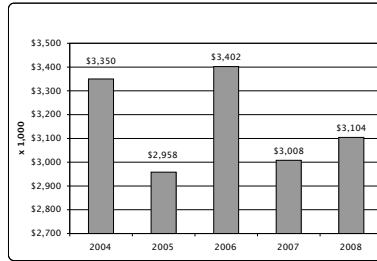
Mifflinburg Bancorp, Inc. is a bank holding company organized under the Pennsylvania Business Corporation Laws on February 3, 1986. The assets are primarily those of its wholly-owned subsidiary, Mifflinburg Bank and Trust Company, established in 1872.

Mifflinburg Bank and Trust Company is a full-service commercial bank servicing customers from five locations, namely: 250 East Chestnut Street, Mifflinburg, Pennsylvania; Fairground Road, Lewisburg, Pennsylvania; 214 Vine Street, New Berlin, Pennsylvania; Rte. 45, Millheim, Pennsylvania and Susquehanna Trail, Selinsgrove, Pennsylvania. Including the stated locations, we have six full-service STAR Automated Teller Machines and six cash dispenser machines in Union, Snyder, and Centre Counties as well as many Point-of-Sale Merchant Locations.

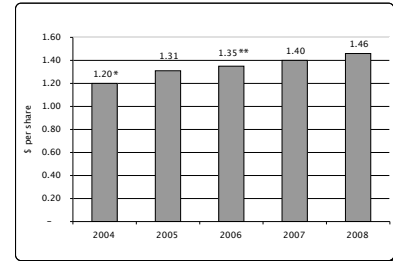
## EARNINGS PER SHARE



## NET INCOME



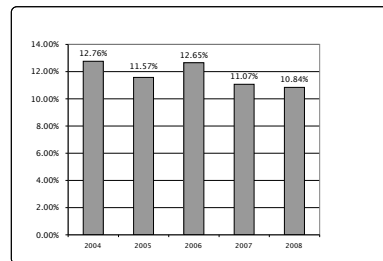
## DIVIDEND PAYOUT HISTORY



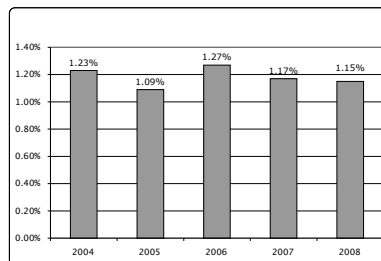
\* Excludes Special dividend of \$3.00 In 2004.

\*\* Excludes Special dividend of \$1.50 In 2006.

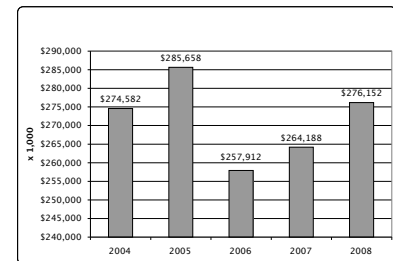
## RETURN ON AVERAGE EQUITY



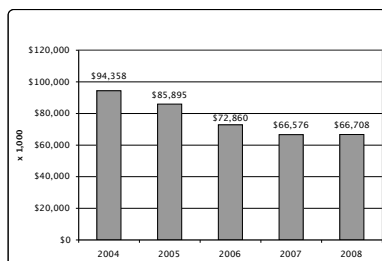
## RETURN ON AVERAGE ASSETS



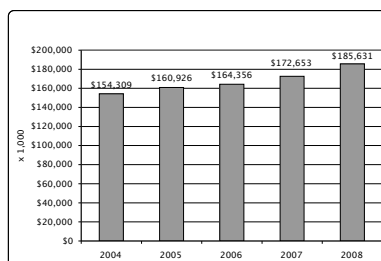
## TOTAL ASSETS



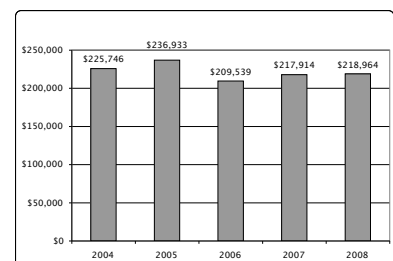
## TOTAL SECURITIES AVAILABLE FOR SALE



## TOTAL LOANS



## TOTAL DEPOSITS





## INDEPENDENT AUDITOR'S REPORT

The Board of Directors and Stockholders  
Mifflinburg Bancorp, Inc.  
Mifflinburg, Pennsylvania

We have audited the accompanying consolidated balance sheets of Mifflinburg Bancorp, Inc. and subsidiary as of December 31, 2008 and 2007, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Mifflinburg 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.

As discussed in Note 1 to the consolidated financial statements, Mifflinburg Bancorp, Inc. adopted the provisions of EITF 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Insurance Agreements*, on January 1, 2008.

*Beard Miller Company LLP*

Beard Miller Company LLP  
Harrisburg, Pennsylvania  
March 2, 2009

Mifflinburg Bancorp, Inc. & Subsidiary  
**CONSOLIDATED BALANCE SHEETS**

**December 31,**  
**(dollars in thousands except share data)**

<b>Assets</b>	<b>2008</b>	<b>2007</b>
Cash and due from banks	\$ 3,724	\$ 4,409
Interest-bearing demand deposits	1,273	503
Federal funds sold	1,806	3,389
<b>Total cash and cash equivalents</b>	<b>6,803</b>	<b>8,301</b>
Interest-bearing time deposits	1,190	992
Trading securities	1,835	4,258
Securities available for sale	66,708	66,576
Investments in restricted stock, at cost	1,517	1,149
Loans	185,631	172,653
Allowance for loan losses	(1,866)	(1,678)
Net loans	183,765	170,975
Premises and equipment, net	5,367	3,468
Accrued interest receivable	1,354	1,126
Foreclosed real estate	-	61
Cash surrender value of life insurance	6,754	6,497
Deferred income taxes	323	296
Other assets	536	489
<b>Total assets</b>	<b>\$ 276,152</b>	<b>\$ 264,188</b>
<b>Liabilities and Stockholders' Equity</b>		
Deposits:		
Noninterest-bearing	\$ 23,972	\$ 22,963
Interest-bearing	194,992	194,951
<b>Total deposits</b>	<b>218,964</b>	<b>217,914</b>
Short-term borrowings	125	129
Federal Home Loan Bank advances	24,572	15,542
Accrued interest payable	812	751
Other liabilities	2,668	2,105
<b>Total liabilities</b>	<b>247,141</b>	<b>236,441</b>
<b>Stockholders' Equity</b>		
Common stock, par value \$1.00; authorized 2,160,000 shares; issued 1,080,000 shares	1,080	1,080
Capital surplus	2,671	2,671
Retained earnings	27,639	26,307
Accumulated other comprehensive income	642	614
Treasury stock at cost: 2008: 80,146 shares/2007: 78,150 shares	(3,021)	(2,925)
<b>Total stockholders' equity</b>	<b>29,011</b>	<b>27,747</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 276,152</b>	<b>\$ 264,188</b>

See accompanying notes to consolidated financial statements.

Mifflinburg Bancorp, Inc. & Subsidiary  
**CONSOLIDATED STATEMENTS OF INCOME**

**Year Ended December 31,**  
**(in thousands except per share data)**

	2008		2007
Interest and dividend income:			
Interest and fees on loans	\$ 11,675	\$	11,466
Interest-bearing deposits in banks	73		40
Federal funds sold	60		189
Securities:			
Taxable	2,030		1,882
Exempt from federal income tax	1,156		1,207
Dividends	87		118
<b>Total interest and dividend income</b>	<b>15,081</b>		<b>14,902</b>
Interest expense:			
Deposits	5,026		6,081
Federal Home Loan Bank advances	895		718
Other borrowings	34		53
<b>Total interest expense</b>	<b>5,955</b>		<b>6,852</b>
Net interest income	9,126		8,050
Provision for loan losses	259		140
<b>Net interest income after provision for loan losses</b>	<b>8,867</b>		<b>7,910</b>
Other income:			
Service charges on deposit accounts	667		711
Gain on sale of loans	106		99
Trust department income	133		158
Commissions from investment product sales	53		57
Trading (losses) gains	(45)		43
Net securities (losses) gains	(199)		123
Gain on sale of foreclosed real estate	7		-
Earnings on cash surrender value of life insurance	301		279
Other	377		330
<b>Total other income</b>	<b>1,400</b>		<b>1,800</b>
Other expense:			
Salaries and employee benefits	3,876		3,571
Net occupancy and equipment expense	628		603
Data processing fees	243		249
State shares tax	292		284
Other	1,239		1,175
<b>Total other expense</b>	<b>6,278</b>		<b>5,882</b>
Income before income taxes	3,989		3,828
Income taxes	885		820
<b>Net income</b>	<b>\$ 3,104</b>	\$	<b>3,008</b>
<b>Earnings per share</b>	<b>\$ 3.10</b>	\$	<b>3.00</b>

See accompanying notes to consolidated financial statements.

Mifflinburg Bancorp, Inc. & Subsidiary  
**CONSOLIDATED STATEMENTS  
OF CHANGES IN STOCKHOLDERS' EQUITY**

**Year Ended December 31, 2008 and 2007**  
(dollars in thousands except per share data)

	Common stock	Capital surplus	Retained earnings	Accumulated other comprehensive income	Treasury stock	Total
Balance - December 31, 2006	\$1,080	\$2,671	\$24,936	\$365	\$(2,848)	\$26,204
Cumulative effect of early adoption of SFAS 159, net of tax benefit			(234)	89		(145)
Comprehensive income:						
Net income			3,008			3,008
Change in unrealized gains on securities, net of reclassification adjustments and taxes				160		160
Total comprehensive income						3,168
Purchase of 1,690 shares of treasury stock					(77)	(77)
Cash dividends declared (\$1.40 per share)			(1,403)			(1,403)
Balance - December 31, 2007	\$1,080	\$2,671	\$26,307	\$614	\$(2,925)	\$27,747
Cumulative effect of adoption of EITF 06-04			(311)			(311)
Comprehensive income:						
Net income			3,104			3,104
Change in unrealized gains on securities, net of reclassification adjustments and taxes				28		28
Total comprehensive income						3,132
Purchase of 1,996 shares of treasury stock					(96)	(96)
Cash dividends declared (\$1.46 per share)			(1,461)			(1,461)
<b>Balance - December 31, 2008</b>	<b>\$1,080</b>	<b>\$2,671</b>	<b>\$27,639</b>	<b>642</b>	<b>\$(3,021)</b>	<b>\$29,011</b>

See accompanying notes to consolidated financial statements.

Mifflinburg Bancorp, Inc. & Subsidiary  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

Year Ended December 31,  
(in thousands)

	2008	2007
Operating activities:		
Net Income	\$ 3,104	\$ 3,008
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	259	246
Net accretion of discounts and premiums on securities	(142)	(125)
Deferred income taxes	(41)	50
Provision for loan losses	259	140
Change in accrued interest receivable	(228)	28
Change in accrued interest payable	61	(140)
Net realized gain on sale of foreclosed real estate	(7)	-
Increase in cash surrender value of life insurance	(257)	(238)
Net securities losses (gains)	199	(123)
Trading losses (gains)	45	(43)
Trading securities:		
Proceeds from paydowns, maturities and calls	1,074	1,273
Proceeds from sales	1,303	5,497
Origination of loans held for sale	(1,682)	(759)
Proceeds from loans sold	1,788	858
Gain on sale of loans	(106)	(99)
Other, net	205	(90)
<b>Net cash provided by operating activities</b>	<b>5,834</b>	<b>9,483</b>
Investing activities:		
Securities available-for-sale:		
Purchases	(13,500)	(17,098)
Proceeds from paydowns, maturities and calls	12,617	11,647
Proceeds from sales	737	1,228
Net increase in loans	(13,049)	(8,407)
Proceeds from sale of foreclosed real estate	68	-
Net purchase of interest-bearing time deposits	(198)	(892)
Net (increase) decrease in restricted stock	(368)	225
Purchases of premises and equipment	(2,158)	(127)
<b>Net cash used in investing activities</b>	<b>(15,851)</b>	<b>(13,424)</b>
Financing activities:		
Net increase in deposits	1,050	8,375
Proceeds from Federal Home Loan Bank advances	12,578	3,042
Repayment of Federal Home Loan Bank advances	(3,548)	(6,658)
Net change in short-term borrowings	(4)	17
Purchase of treasury stock	(96)	(77)
Dividends paid on common stock	(1,461)	(1,403)
<b>Net cash provided by financing activities</b>	<b>8,519</b>	<b>3,296</b>
<b>Net change in cash and cash equivalents</b>	<b>(1,498)</b>	<b>(645)</b>
Cash and cash equivalents at beginning of year	8,301	8,946
<b>Cash and cash equivalents at end of year</b>	<b>\$ 6,803</b>	<b>\$ 8,301</b>
Supplemental disclosures:		
Interest paid	\$ 5,894	\$ 6,992
Income taxes paid	\$ 799	\$ 755
Transfer of loans to foreclosed real estate	\$ -	\$ 61

See accompanying notes to consolidated financial statements.

Mifflinburg Bancorp, Inc. & Subsidiary  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** \_\_\_\_\_

Mifflinburg Bancorp, Inc. (the Company) is a Pennsylvania corporation organized as the holding company of Mifflinburg Bank and Trust Company (the Bank). The Bank is a state chartered commercial bank located in Mifflinburg, Pennsylvania, whose principal sources of revenues are derived from its commercial, mortgage, residential real estate, and consumer loan financing as well as a variety of deposit services provided to customers serviced by its five offices. Milestone Insurance Services, LLC (Milestone) was formed in 2003 and is a wholly owned subsidiary of the Bank. Milestone is licensed to sell title insurance. The Company is supervised by the Board of Governors of the Federal Reserve System while the Bank is subject to regulation and supervision by the Federal Deposit Insurance Corporation and the Pennsylvania Department of Banking. A summary of significant accounting and reporting policies applied in the presentation of the accompanying financial statements follows.

***Basis of Presentation***

The accounting policies followed by the Company and the Bank and the methods of applying these policies conform with accounting principles generally accepted in the United States of America and with general practice within the banking industry. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and require disclosure of contingent assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the evaluation of other than temporary impairment of securities available for sale.

***Principles of Consolidation***

The accompanying consolidated financial statements include the accounts of the Company and the Bank, its wholly-owned subsidiary. All significant intercompany balances and transactions have been eliminated. The entire business of the Company is managed as one operating segment.

***Cash and Cash Equivalents***

For purposes of the statement of cash flows, the Company defines cash equivalents as cash and due from banks, interest-bearing demand deposits and federal funds sold. Federal funds are generally sold for one day periods.

***Trading Securities***

Securities classified as trading consist of assets held in tax exempt municipal bonds and collateralized mortgage obligations and are stated at fair value. Unrealized changes in fair value are reported in earnings. Interest and dividends are included in interest income.

***Securities***

Debt securities and equity securities classified as available for sale are carried at fair value with unrealized gains and losses net of the related tax effects reflected as a separate component of stockholders' equity. Securities classified as available for sale are those debt securities that the Company intends to hold for an indefinite period of time, but not necessarily to maturity. Any decision to sell a security classified as available for sale would be based on various factors, including significant movements in interest rates, changes in the maturity mix of the Company's assets and liabilities, liquidity needs, regulatory capital considerations, and other similar factors.

Premium amortization and discount accretion are recorded using the interest method over each security's expected life. Declines in the fair value of 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

Mifflinburg Bancorp, Inc. & Subsidiary  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** *(cont'd)* \_\_\_\_\_

considers independent price quotations, projected target prices of investment analysts within the short term and the financial condition of the issuer. Realized gains and losses on sales of securities represent differences between net proceeds and carrying amounts determined by the average cost method for equity securities and the specific identification method for all other securities.

***Federal Home Loan Bank Stock***

As a member of the Federal Home Loan Bank (FHLB) of Pittsburgh, the Bank is required to maintain an investment in FHLB restricted stock based on mortgage loans, advances and other criteria. As no active market exists for this stock, it is carried at cost. All FHLB stock is pledged as collateral for FHLB advances.

Management evaluates the FHLB stock for impairment in accordance with Statement of Position (SOP) 01-6, *Accounting by Certain Entities (Including Entities With Trade Receivables) That Lend to or Finance the Activities of Others*. Management's determination of whether these investments are impaired is based on their assessment of the ultimate recoverability of their cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of their cost is influenced by criteria such as (1) the significance of the decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, and (3) the impact of legislative and regulatory changes on institutions and, accordingly on the customer base of the FHLB.

Management believes no impairment charge is necessary related to the FHLB restricted stock as of December 31, 2008 and 2007.

***Loans***

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at unpaid principal balance net of unamortized deferred loan fees and costs and the allowance for loan losses. Interest on loans is computed on the unpaid principal balance. The accrual of interest income on loans is discontinued when, in the opinion of management, there exists doubt as to the ability to collect such interest. This generally occurs when a loan becomes 90 days delinquent as to principal or interest unless the loan is well collateralized and in the process of collection.

When a loan is placed on nonaccrual status, unpaid interest credited to income in the current year is reversed and unpaid interest accrued in prior years is charged against the allowance for loan losses. Interest received on nonaccrual loans generally is either applied against principal or reported as interest income, according to management's judgment as to the collectibility of principal. Loans are returned to an accrual status when payments become current and other factors indicate that the Bank believes the loan will be fully collectible. The Company recognizes nonrefundable loan origination fees and certain direct loan origination costs over the life of the related loans as an adjustment of loan yield using the interest method. The amortization of net loan fees or costs is discontinued for nonaccrual loans.

Loan impairment is evaluated individually for significant loans. Management, considering current information and events regarding the borrowers' ability to repay their obligations, considers a loan to be impaired when it is probable that the Bank will be unable to collect all amounts when due according to the contractual terms of the loan agreement.

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. When a loan is considered to be impaired, the amount of the impairment is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, or at the fair value of the collateral if the loan is collateral dependent. Interest income on impaired loans is generally recorded as payments are collected based on management's judgment as to the collectibility of principal.

Mifflinburg Bancorp, Inc. & Subsidiary  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** *(cont'd)* \_\_\_\_\_

***Allowance for Loan Losses***

The allowance for loan losses represents the amount which management estimates is adequate to provide for inherent losses in the loan portfolio. All loans deemed to be uncollectible are charged to the allowance and all recoveries are credited to it. The allowance for loan losses is established through a provision for loan losses charged to operations. The allowance for loan losses consists of specific, general and unallocated components. The specific component relates to loans that are classified as doubtful, substandard or special mention. Further, for any loans that are classified as impaired, if necessary, a specific allowance is established and will be based upon either a discounted cash flow analysis or the discounted realizable collateral value of the property. The general component is based upon a segmentation of loans into pools with similar characteristics. The identified loans within these pools are then allocated to the remaining unclassified loan portfolio. The unallocated component is the least material and is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component reflects the margin of imprecision inherent in the underlying assumptions used in estimating the specific and general losses in the loan portfolio.

***Foreclosed Real Estate***

Foreclosed real estate consists of real estate acquired in settlement of foreclosed loans and is recorded at fair value less estimated costs to sell. Valuation allowances are established when the carrying amount exceeds the fair value less estimated costs to sell. Costs related to the acquisition and holding of foreclosed real estate are charged to operations when incurred. The fair value of real estate acquired through foreclosure is generally determined by reference to an outside appraisal.

***Premises and Equipment***

Premises and equipment are stated at cost less accumulated depreciation. Repairs and maintenance expenditures are expensed as incurred. The costs of major additions and improvements are capitalized. When premises or equipment are retired or sold, the remaining cost and accumulated depreciation are removed from the accounts and any gain or loss is credited or charged to income. Depreciation is computed using straight-line and accelerated methods over the estimated useful lives of the assets.

***Cash Surrender Value of Life Insurance***

Cash surrender value of life insurance is carried at its net cash surrender value as determined by the insurance companies. The value represents the amount of premiums invested and earnings thereon. Premiums for purchases of life insurance with a cash surrender value are capitalized. Earnings on the cash surrender value of life insurance are included in other income while expenses are recorded as a component of other expenses in the Consolidated Statements of Income.

On January 1, 2008, the Company adopted Emerging Issues Task Force ("EITF") Issue 06-4 "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split Dollar Life Insurance Agreements." EITF 06-4 requires recognition of a liability for postretirement benefits provided through an endorsed split-dollar life insurance arrangement. As a result of recording the cumulative effect of this liability, retained earnings was decreased by \$311,000 as of the adoption date. Expense related to this EITF in the year ended December 31, 2008 totaled \$9,000.

***Servicing***

Servicing assets are recognized as separate assets when rights are acquired through purchase or through sale of financial assets. Capitalized servicing rights are reported in other assets and are amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is determined by stratifying rights by predominant characteristics, such as interest rates and terms. Fair value is determined using prices for similar assets with similar characteristics, when available, or based upon discounted cash flows using market-based assumptions. Impairment is recognized through a valuation allowance for an individual stratum, to the extent that fair value is less than the capitalized amount for the stratum.

Mifflinburg Bancorp, Inc. & Subsidiary  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** *(cont'd)* \_\_\_\_\_

***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.

***Advertising Expenses***

Advertising costs are expensed as incurred and totaled \$128,000 in 2008 and \$119,000 in 2007.

***Income Taxes***

Deferred income taxes are provided on the liability method whereby deferred tax assets are recognized for deductible temporary differences and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax basis. Deferred tax assets are reduced by a valuation allowance, when in the opinion of management, it is more likely than not that some portion or all the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted through the provision for income taxes for the effects of changes in tax laws and rates on the date of enactment.

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 FSP requires a nonpublic enterprise that elects to defer the application of FIN 48 to explicitly disclose that fact and also requires the disclosure of the enterprise's accounting policy for evaluating uncertain tax positions for each set of financial statements where the deferral applies.

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*.

***Earnings Per Share***

The Company does not have any common stock equivalents and therefore is required to present only basic earnings per share, which represents net income divided by the weighted average shares outstanding during the period. The weighted average shares outstanding during 2008 and 2007 were 1,001,074 and 1,002,523, respectively.

***Treasury Stock***

The acquisition of treasury stock is recorded under the cost method. The subsequent disposition or sale of the treasury stock is recorded using the average cost method.

***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 letters of credit. Such financial instruments are recorded on the balance sheet as they are funded.

***Comprehensive Income***

Comprehensive income is reflected in the Consolidated Statements of Changes in Stockholders' Equity and includes net income and unrealized gains or losses on investment securities classified as available for sale.

Mifflinburg Bancorp, Inc. & Subsidiary  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** *(cont'd)* \_\_\_\_\_

***Trust Assets***

Assets held by the Bank in a fiduciary or agency capacity for its customers are not included in the consolidated financial statements since such items are not assets of the Company. Trust income is recorded on a cash basis, which is not materially different from the accrual basis.

***Reclassifications***

Certain amounts in the 2007 Consolidated Financial Statements have been reclassified to conform to the 2008 presentation. Such reclassifications had no impact on net income.

**(2) TRADING ASSETS AND LIABILITIES** \_\_\_\_\_

On January 1, 2007 the Company early adopted FAS No. 159, The Fair Value Option for Financial Assets and Liabilities, including an Amendment of FASB Statement No. 115, and FAS No. 157, Fair Value Measurement. As a result of this early adoption, \$11.0 million of available for sale securities with significant interest rate risk characteristics were marked-to-market and classified as trading. In addition \$3.9 million of FHLB debt with significantly above market rates were also classified as trading and marked-to-market. Subsequently \$4.7 million of trading securities were sold and the proceeds were used to pay off FHLB borrowings classified as trading. The initial adoption of FAS No. 159 resulted in a decrease in Stockholders' Equity of \$145,000, which was net of a tax benefit of \$74,000.

Trading securities at fair value, consist of the following at December 31 (in thousands):

	2008		2007	
Tax exempt municipal bonds	\$	292	\$	1,634
Collateralized mortgage obligations		1,543		2,624
Total	\$	1,835	\$	4,258

Trading securities unrealized gains of approximately \$3,000 and \$106,000 are included in 2008 and 2007 earnings related to securities still held at December 31, 2008 and 2007. Trading security unrealized losses of approximately \$23,000 and \$68,000 are included in 2008 and 2007 earnings related to securities still held at December 31, 2008 and 2007. Realized gains and losses on sales of trading securities were \$0 and \$25,000 in 2008, and \$2,000 and \$9,000 in 2007, respectively. In 2007 the Bank realized gains on its' trading liabilities in the amount of \$12,000.

Mifflinburg Bancorp, Inc. & Subsidiary  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(3) SECURITIES AVAILABLE FOR SALE**

The amortized cost and fair value of securities available for sale are as follows at December 31, (in thousands):

	2008				2007			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
U.S. government agencies	\$ 4,639	\$ 73	\$ -	\$ 4,712	\$ 5,708	\$ 49	\$ -	\$ 5,757
Taxable state and municipal	1,612	1	(113)	1,500	1,055	-	(31)	1,024
Tax exempt state and municipal	24,563	621	(247)	24,937	25,073	538	(118)	25,493
Mortgage-backed securities	33,339	772	(18)	34,093	32,331	341	(25)	32,647
Corporate securities	475	-	(56)	419	-	-	-	-
<b>Total debt securities</b>	<b>64,628</b>	<b>1,467</b>	<b>(434)</b>	<b>65,661</b>	<b>64,167</b>	<b>928</b>	<b>(174)</b>	<b>64,921</b>
Equity securities	1,103	96	(152)	1,047	1,477	262	(84)	1,655
<b>Total</b>	<b>\$ 65,731</b>	<b>\$ 1,563</b>	<b>\$ (586)</b>	<b>\$ 66,708</b>	<b>\$ 65,644</b>	<b>\$ 1,190</b>	<b>\$ (258)</b>	<b>\$ 66,576</b>

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

	Amortized Cost	Fair value
Due in one year or less	\$ 7,354	\$ 7,515
Due after one year through five years	13,336	13,713
Due after five years through ten years	4,185	4,258
Due after ten years	6,414	6,082
	<b>31,289</b>	<b>31,568</b>
Mortgage-backed securities	33,339	34,093
<b>Total</b>	<b>\$ 64,628</b>	<b>\$ 65,661</b>

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

2008	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Description of Securities						
Taxable state and municipal	\$ 531	\$ 28	\$ 415	\$ 85	\$ 946	\$ 113
Tax-exempt state and municipal	4,693	182	1,128	65	5,821	247
Mortgage backed securities	3,001	18	-	-	3,001	18
Corporate securities	418	56	-	-	418	56
<b>Subtotal, debt securities</b>	<b>8,643</b>	<b>284</b>	<b>1,543</b>	<b>150</b>	<b>10,186</b>	<b>434</b>
Equity securities	275	50	241	102	516	152
<b>Total temporarily Impaired securities</b>	<b>\$ 8,918</b>	<b>\$ 334</b>	<b>\$ 1,784</b>	<b>\$ 252</b>	<b>\$ 10,702</b>	<b>\$ 586</b>
2007	Less than 12 months		12 months or more		Total	
Description of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Taxable state and municipal	\$ 484	\$ 16	\$ 540	\$ 15	\$ 1,024	\$ 31
Tax-exempt state and municipal	1,968	21	5,094	97	7,062	118
Mortgage backed securities	2,446	22	857	3	3,303	25
<b>Subtotal, debt securities</b>	<b>4,898</b>	<b>59</b>	<b>6,491</b>	<b>115</b>	<b>11,389</b>	<b>174</b>
Equity securities	602	55	61	29	663	84
<b>Total temporarily Impaired securities</b>	<b>\$ 5,500</b>	<b>\$ 114</b>	<b>\$ 6,552</b>	<b>\$ 144</b>	<b>\$ 12,052</b>	<b>\$ 258</b>

Mifflinburg Bancorp, Inc. & Subsidiary  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(3) SECURITIES AVAILABLE FOR SALE** *(cont'd)*

At December 31, 2008, the \$334,000 unrealized loss (less than 12 months) was attributed to 36 different securities. The \$252,000 unrealized loss (12 months or more) was attributed to 17 different securities. None of the unrealized losses is significant. Management believes that the unrealized losses on debt securities were the result of fluctuations in market interest rates subsequent to purchase. Management has the intent and ability to hold investments until the earlier of maturity or market price recovery, accordingly no debt securities are deemed to be other-than-temporarily impaired.

The Company's equity securities with unrealized losses are comprised of common stock in varying industries. The Company has established different parameters for evaluating equity securities for other than temporary impairment. These parameters include, but are not limited to, the length of time in an unrealized loss position and the amount of the unrealized loss. At December 31, 2008 no equity securities are deemed to be other-than-temporarily impaired.

Below is a summary of gross gains and gross losses realized on the sale of securities available for sale (in thousands). For the year ended December 31, 2008 gross security losses in the amount of \$254,000 were recognized in order to restructure the equity securities portfolio due to the current market environment.

For the year ended	2008	2007
Gross gains	\$ 55	\$ 205
Gross losses	\$ (254)	\$ (82)

Securities with a carrying value of \$37,758,000 and \$35,678,000 at December 31, 2008 and 2007, respectively, were pledged to secure public deposits and for other purposes as required by law.

**(4) LOANS**

Major categories of loans are summarized as follows as of December 31, (in thousands):

	2008	2007
Loans secured by real estate:		
Construction and land development	\$ 1,125	\$ 1,684
Farmland	23,138	22,146
Home equity lines of credit	1,862	1,705
Residential	64,524	62,338
Commercial	51,040	47,845
Agricultural	1,265	814
Commercial	19,039	20,209
Consumer	18,597	12,010
State and municipal	5,191	4,059
<b>Total</b>	<b>185,781</b>	<b>172,810</b>
Less: net deferred loan fees	(150)	(157)
<b>Total loans net of net deferred loan fees</b>	<b>185,631</b>	<b>172,653</b>
Less: allowance for loan losses	(1,866)	(1,678)
<b>Net loans</b>	<b>\$ 183,765</b>	<b>\$ 170,975</b>

Mifflinburg Bancorp, Inc. & Subsidiary  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(4) LOANS** *(cont'd)*

The following summarizes information concerning the Bank's impaired loans at and for the years ended December 31, (in thousands):

	2008	2007
Impaired loans at year end	\$ 684	\$ -
Average impaired loans for the year	316	-
Impaired loans requiring a specific allowance	410	-
Specific allowance for impaired loans	30	-
Interest income recognized on impaired loans	42	-

Nonaccrual loans at December 31, 2008 and 2007 totaled \$373,000 and \$413,000, respectively. Interest foregone on nonaccrual loans was approximately \$3,000 and \$2,000 during 2008 and 2007, respectively.

At December 31, 2008 and 2007, there were \$134,000 and \$50,000, respectively, of loans that were past due 90 days or more and still accruing interest.

In the normal course of business, loans are extended to directors, executive officers, and their associates. In management's opinion, all of these loans are on substantially the same terms and conditions as loans to other individuals and businesses of comparable creditworthiness.

A summary of loan activity for those directors, executive officers, and their associates is as follows (in thousands):

Dec. 31, 2007	New Loans	Repayments	Dec. 31, 2008
\$4,221	\$507	\$244	<b>\$4,484</b>

The Bank grants commercial, residential, and personal loans to customers primarily in Union County, Pennsylvania. Although the Bank has a diversified loan portfolio, a significant portion of its debtors' ability to honor their contracts is dependent on the economic conditions within this region. Additionally, approximately 13% of the Bank's loans at December 31, 2008 and 2007 are to individuals in the agricultural business.

The Bank has entered into an agreement to sell residential mortgages to the Federal Home Loan Bank of Pittsburgh. The maximum to be sold under the agreement is \$50 million, and \$39.8 million has been sold under this agreement as of December 31, 2008.

Loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balances of mortgage loans serviced for others were \$24,136,000 and \$25,741,000 at December 31, 2008 and 2007 respectively.

The balance of capitalized servicing rights included in other assets was \$75,000 at December 31, 2008 and 2007.

The balance of capitalized credit enhancement fees included in other assets at December 31, 2008 and 2007 was \$38,000 and \$41,000 respectively.

**(5) ALLOWANCE FOR LOAN LOSSES**

Changes in the allowance for loan losses for the years ended December 31, are as follows (in thousands):

	2008	2007
Balance, January 1	\$ 1,678	\$ 1,587
Provision for loan losses	259	140
Recoveries	55	40
Loans charged off	(126)	(89)
Balance, December 31	<b>\$ 1,866</b>	\$ 1,678

Mifflinburg Bancorp, Inc. & Subsidiary  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(6) PREMISES AND EQUIPMENT**

Major classifications of premises and equipment are summarized as follows at December 31, (in thousands):

	2008	2007	Estimated useful life
Land	\$ 291	\$ 291	
Buildings	4,040	3,959	25-39 years
Furniture and fixtures	2,308	2,248	3-7 years
Automobiles	116	97	5 years
Construction in progress	1,984	-	
	<b>8,739</b>	6,595	
Less accumulated depreciation	<b>3,372</b>	3,127	
<b>Total</b>	<b>\$ 5,367</b>	\$ 3,468	

As of December 31, 2008, the Bank has entered into a construction commitment in the amount of \$1.5 million to be paid within one year or less.

**(7) LEASES**

The Bank leases facilities under noncancellable operating leases which expire in various years through 2013. The minimum annual rental commitments under these leases at December 31, 2008 are as follows (in thousands):

2009	<b>\$16</b>
2010	<b>6</b>
2011	<b>6</b>
2012	<b>7</b>
2013	<b>1</b>
<b>Total</b>	<b>\$36</b>

The total rental expense for these operating leases in 2008 and 2007 amounted to \$15,000 and \$10,000, respectively.

**(8) DEPOSITS**

Time deposits include certificates of deposit in denominations of \$100,000 or more. Such deposits aggregated \$28,417,000 and \$25,613,000 at December 31, 2008 and 2007, respectively.

A summary of the maturity of time deposits as of December 31, 2008 is as follows (in thousands):

2009	\$	<b>53,873</b>
2010		<b>21,746</b>
2011		<b>9,599</b>
2012		<b>5,944</b>
2013		<b>5,418</b>
<b>Total</b>	\$	<b>96,580</b>

**(9) SHORT-TERM BORROWINGS**

Short-term borrowings consist of a treasury, tax, and loan account in the amounts of \$125,000 and \$129,000 as of December 31, 2008 and 2007, respectively. The interest rates on these borrowings were 0% and 4.02% as of December 31, 2008 and 2007, respectively.

**(10) FEDERAL HOME LOAN BANK ADVANCES**

The Bank maintains a borrowing agreement with the FHLB of Pittsburgh with an available funding capacity of approximately \$79 million as of December 31, 2008. This agreement is subject to annual renewal, incurs no service charges, and is secured by a blanket security agreement on outstanding residential mortgage loans.

The FHLB advances are collateralized by the security agreement and FHLB capital stock. The FHLB's adjustable-rate advances adjust quarterly at .13% above three-month LIBOR.

Mifflinburg Bancorp, Inc. & Subsidiary  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(10) FEDERAL HOME LOAN BANK ADVANCES** *(cont'd)*

Federal Home Loan Bank advances consist of separate loans with the Federal Home Loan Bank of Pittsburgh as of December 31 as follows (in thousands):

	2008		2007	
	Amount	Rate	Amount	Rate
FHLB fixed-rate advances maturing:				
2008	\$ -	- %	\$ 3,542	4.21 %
2009	4,775	4.29	4,583	4.31
2010	4,276	3.62	2,535	3.87
2011	4,541	3.43	1,250	3.88
2012	4,716	3.57	1,000	3.50
2013	3,724	3.92	1,500	3.70
2014	1,233	3.95	-	-
2015	1,181	4.57	1,000	4.70
FHLB first time homebuyers program:				
2015-2018	126	5.00-5.50	132	5.00-5.50
<b>Total</b>	<b>\$ 24,572</b>		<b>\$ 15,542</b>	

**(11) INCOME TAXES**

The provision for income taxes consists of the following (in thousands):

For the year ended December 31,

	2008	2007
Current	\$ 926	\$ 770
Deferred	(41)	50
<b>Total provision</b>	<b>\$ 885</b>	<b>\$ 820</b>

Income tax (benefit) expense of (\$68,000) and 42,000 were recognized on net securities (losses) gains in 2008 and 2007, respectively.

The tax effects of deductible and taxable temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, are as follows (in thousands):

	2008	2007
Deferred tax assets:		
Allowance for loan losses	\$ 549	\$ 486
Deferred compensation	518	479
Net unrealized losses on trading securities	-	7
<b>Total</b>	<b>1,067</b>	<b>972</b>
Deferred tax liabilities:		
Net unrealized gains on securities	331	317
Premises and equipment	175	159
Deferred loan origination fees, net	127	118
Unrealized gains trading securities	4	-
Other	107	82
<b>Total</b>	<b>744</b>	<b>676</b>
<b>Net deferred tax asset</b>	<b>\$ 323</b>	<b>\$ 296</b>

Mifflinburg Bancorp, Inc. & Subsidiary  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(11) INCOME TAXES** *(cont'd)*

A reconciliation between the expected statutory income tax rate of 34% and the effective income tax rate on income before income taxes is as follows (dollars in thousands):

	2008		2007	
	Amount	Percentage	Amount	Percentage
Provision at statutory rate	\$ 1,356	34.0 %	\$ 1,302	34.0 %
Tax-exempt interest	(474)	(11.9)	(527)	(13.8)
Nondeductible interest expense	47	1.2	63	1.6
Net increase in cash surrender value of life insurance	(88)	(2.2)	(81)	(2.1)
Other, net	44	1.1	63	1.7
<b>Applicable income taxes and effective rates</b>	<b>\$ 885</b>	<b>22.2 %</b>	<b>\$ 820</b>	<b>21.4 %</b>

**(12) COMPREHENSIVE INCOME**

Accounting principles generally accepted in the United States of America require that recognized revenue, expenses, gains, and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income are components of comprehensive income.

The only comprehensive income item that the Company presently has is unrealized gains (losses) on securities available for sale. The federal income taxes allocated to the unrealized gains (losses) are presented in the table below. The reclassification adjustments included in comprehensive income are also presented (in thousands).

	Year ended December 31,	
	2008	2007
Unrealized holding (losses) gains arising during the year	\$ (157)	\$ 367
Reclassification adjustment for losses (gains) included in net income	199	(123)
Net unrealized gains	42	244
Tax expense	(14)	(84)
<b>Net of tax amount</b>	<b>\$ 28</b>	<b>\$ 160</b>

**(13) EMPLOYEE BENEFITS PLANS**

***Section 401(k) Plan***

The Bank sponsors a contributory defined contribution Section 401(k) plan covering substantially all employees who have completed one year of service and have attained age twenty-one. The plan permits employees to make pre-tax contributions which are matched by the Bank up to four percent of the employee's compensation. The Bank's contributions were \$85,000 and \$77,000 in 2008 and 2007, respectively. Contributions made by the Bank vest ratably beginning after the third year of service and are fully vested after an employee completes six years of service.

During 2008 the Bank added a profit sharing employer contribution component to the 401(k) Plan. The profit sharing employer contribution will be made at the discretion of the management and Board of Directors based upon current year earnings. The employer contribution was \$171,000 for 2008.

***Money Purchase Plan***

Effective January 1, 2008, the Money Purchase Plan was discontinued and the plan assets were merged with the Bank's 401(k) Plan. Prior to 2008, the Bank sponsored a defined contribution, non-contributory money purchase

Mifflinburg Bancorp, Inc. & Subsidiary  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(13) EMPLOYEE BENEFITS PLANS** *(cont'd)* \_\_\_\_\_

plan covering substantially all employees who had completed one year of service and had attained age twenty-one. Employees were partially vested after three years of service and fully vested after seven years of service. Employer contributions were based upon total wages as defined and amounted to \$140,000 in 2007.

***Deferred Directors' Compensation***

The Bank maintains deferred compensation plans with directors through which the payments of the directors' fees are deferred. The future liability of these agreements, which is payable in ten annual installments, was financed through the purchase of life insurance contracts which required a one-time premium of \$1,570,000.

The present value of the future liability of the plans at December 31, 2008 and 2007, was \$896,000 and \$775,000, respectively. The related expenses amounted to \$73,000 and \$70,000 for the years ended 2008 and 2007, respectively.

***Supplemental Plan***

The Company maintains an arrangement for supplemental compensation (the "Supplemental Plan") for certain of its executive officers and directors (the "Executives"). The Supplemental Plan provides that the Bank and the Executives share in the rights to the death benefits of bank owned split-dollar life insurance policies (the "BOLI Policies") and provides for additional compensation to the Executives, equal to any income tax consequences related to the Supplemental Plan until retirement. The amount of the BOLI Policies has been calculated so that the projected increases in their cash surrender value will substantially offset the Bank's expense related to the Supplemental Plan. The Supplemental Plan is designed to provide certain Executives, upon attaining age 65, with projected annual distributions.

The amount of the benefit obligation is increased or decreased each year by an amount equal to the annual BOLI Policies' earnings less the Bank's cost of funds. In addition, the BOLI Policies are intended to provide the directors with \$100,000 of supplemental life insurance and the executive officers with supplemental life insurance equal to three times salary. Neither the insurance company nor Mifflinburg Bancorp, Inc. has guaranteed any minimum cash value under the Supplemental Plan. The expense recognized by the Bank under the plan was \$41,000 and \$34,000 for the years ended 2008 and 2007, respectively. This expense was offset by an increase in the cash surrender value of the BOLI Policies of \$128,000 and \$121,000 for the years ended 2008 and 2007, respectively.

The liability of the Supplemental Plan at December 31, 2008 and 2007 was \$578,000 and \$ 537,000, respectively.

**(14) REGULATORY MATTERS** \_\_\_\_\_

***Cash and Due From Banks***

Included in cash and due from banks are reserves of \$133,000 and \$114,000 at December 31, 2008 and 2007, respectively, required by the Federal Reserve Bank. The required reserves are computed by applying prescribed ratios to the various classes of average deposit accounts. The reserves are held in the form of cash. Deposits with one financial institution are insured up to \$250,000. The Company maintains cash and cash equivalents with certain financial institutions in excess of the insured amount.

***Loans***

Federal law prevents Mifflinburg Bancorp, Inc. from borrowing from its bank subsidiary unless the loans are secured by specified collateral. Further, such secured loans are limited in amount to ten percent of the Bank's common stock and capital surplus. There were no such loans in 2008 or 2007.

***Regulatory Capital Requirements***

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet capital requirements can initiate certain mandatory, and possibly additional discretionary actions by the regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital ad-

Mifflinburg Bancorp, Inc. & Subsidiary  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(14) REGULATORY MATTERS** *(cont'd)*

equacy 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.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of Total and Tier I Capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital to average assets (as defined). Management believes, as of December 31, 2008 and 2007, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2008 the most recent notification from the Federal Deposit Insurance Corporation has categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There have been no conditions or events since that notification that management believes have changed the Bank's category. To be categorized as well capitalized, the Bank must maintain minimum Total risk-based and Tier I leverage ratios as set forth below.

The Federal Reserve Board approved a final rule in 2006 that expands the definition of a small bank holding company ("BHC") under the Board's Small Bank Holding Company Policy Statement and the Board's risk-based and leverage capital guidelines for bank holding companies. Based on the ruling, the Company meets the eligibility criteria of a small BHC and is exempt from regulatory requirements administered by the federal banking agencies.

The following table reflects the Bank's capital ratios at December 31.

	2008		2007	
<b>Total Capital (to Risk Weighted Assets)</b>	(Dollars in Thousands)			
Actual	<b>\$28,757</b>	<b>14.56%</b>	\$27,231	14.72%
For capital adequacy purposes	<b>15,799</b>	<b>8.00%</b>	14,801	8.00%
To be well capitalized	<b>19,749</b>	<b>10.00%</b>	18,501	10.00%
<b>Tier I Capital (to Risk Weighted Assets)</b>				
Actual	<b>\$26,890</b>	<b>13.62%</b>	\$25,553	13.81%
For capital adequacy purposes	<b>7,900</b>	<b>4.00%</b>	7,401	4.00%
To be well capitalized	<b>11,850</b>	<b>6.00%</b>	11,101	6.00%
<b>Tier I Capital (to Average Assets)</b>				
Actual	<b>\$26,890</b>	<b>9.70%</b>	\$25,553	9.74%
For capital adequacy purposes	<b>11,083</b>	<b>4.00%</b>	10,497	4.00%
To be well capitalized	<b>13,854</b>	<b>5.00%</b>	13,122	5.00%

**Dividends**

Banking regulations limit the amount of dividends that may be paid by the Bank to the Company. Retained earnings against which dividends may be paid without prior regulatory approval amounted to approximately \$13.0 million at December 31, 2008, subject to the minimum capital ratio requirements noted above.

Mifflinburg Bancorp, Inc. & Subsidiary  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**(15) COMMITMENTS AND STANDBY LETTERS OF CREDIT**

In the normal course of business, the Bank makes various commitments which are not reflected in the accompanying financial statements. The Bank offers such products 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, interest rate, or liquidity risk in excess of the amount recognized in the consolidated balance sheet.

The Bank's maximum exposure to credit loss from nonperformance by the other party to the financial instruments for commitments to extend credit and standby letters of credit is represented by the contractual amount of these instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by the Bank on extension of credit is based on management's credit assessment of the counterparty.

Financial instruments whose contract amounts represent credit risk at December 31 are as follows (in thousands):

	Contract Amount	
	2008	2007
Commitments to extend credit	\$40,656	\$37,027
Standby letters of credit	183	1,750

Commitments to extend credit are legally binding agreements to lend to customers as long as there are no violations of the agreements. Commitments generally have fixed expiration dates or other termination clauses and may require payment of fees. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future liquidity requirements.

Outstanding letters of credit written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The majority of these standby letters of credit expire within the next twelve months. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending other loan commitments. The Bank requires collateral supporting these letters of credit as deemed necessary. The current amount of the liability as of December 31, 2008 and 2007 for guarantees under standby letters of credit is not material.

**(16) FAIR VALUE MEASUREMENTS**

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 their respective year-ends and have not been re-evaluated or updated for purposes of these financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at each year-end.

In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement No. 157, "*Fair Value Measurements*" ("SFAS 157"), which defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. The new standard is effective for financial statements issued for fiscal years beginning after November 15, 2007, and for interim periods within those fiscal years. 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 Assset 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

Mifflinburg Bancorp, Inc. & Subsidiary  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(16) FAIR VALUE MEASUREMENTS** *(cont'd)*

and applies to our December 31, 2008 consolidated financial statements. The adoption of SFAS 157 and FSP 157-3 had no impact on the amounts reported in the consolidated financial statements.

The primary effect of SFAS 157 on the Company was to expand the required disclosures pertaining to the methods used to determine fair values.

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 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 21, 2008 and 2007 are as follows:

		(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
<b>December 31, 2008</b>	<b>Total</b>			
Trading securities	\$ 1,835	\$ -	\$ 1,835	\$ -
Securities available for sale	66,708	1,047	65,661	-
<b>Total assets at fair value</b>	<b>\$ 68,543</b>	<b>\$ 1,047</b>	<b>\$ 67,496</b>	<b>\$ -</b>
<b>December 31, 2007</b>				
Trading securities	\$ 4,258	\$ -	\$ 4,258	\$ -
Securities available for sale	66,576	1,655	64,921	-
<b>Total assets at fair value</b>	<b>\$ 70,834</b>	<b>\$ 1,655</b>	<b>\$ 69,179</b>	<b>\$ -</b>

Mifflinburg Bancorp, Inc. & Subsidiary  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(16) FAIR VALUE MEASUREMENTS** *(cont'd)*

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 21, 2008 and 2007 are as follows:

Fair Value Measurements Using				
December 31, 2008	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Impaired loans</b>	\$ 380	\$ -	\$ -	\$ 380
<hr/>				
December 31, 2007				
Impaired loans	\$ -	\$ -	\$ -	\$ -

The following information should not be interpreted as an estimate of the fair value of the entire Company since the 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 and Cash Equivalents (Carred at Cost)***

The carrying amounts reported in the balance sheet for cash and short-term instruments approximate those assets' fair values.

***Time Certificates of Deposit (Carred at Cost)***

Fair values for fixed-rate time 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. The Bank generally purchases amounts below the insured limit, limiting the amount of credit risk on these time deposits.

***Securities***

The fair value of securities available for sale and trading securities (carried at fair value) 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 both internal and external support on certain Level 3 investments. Internal cash flow models using a present value formula that includes assumptions market participants would use along with indicative exit pricing obtained from broker/dealers (where available) were used to support fair values of certain Level 3 investments.

***Loans Receivable (Carried at Cost)***

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

Mifflinburg Bancorp, Inc. & Subsidiary  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(16) FAIR VALUE MEASUREMENTS** *(cont'd)*

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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 (Generally Carried at Fair Value)***

Impaired loans are those that are accounted for under FASB Statement No. 114, *Accounting for 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 balances of \$410,000, net of a valuation allowance of \$30,000. Additional provisions for loan losses of \$30,000 were recorded during the period.

***Servicing Rights (Carried at Lower of Cost or Fair Value)***

The fair value of mortgage servicing rights is based on a valuation model that calculates the present value of estimated net servicing income. The valuation incorporates assumptions that market participants would use in estimating future net servicing income. The Bank is able to compare the valuation model inputs and results to widely available published industry data for reasonableness.

***Investments in Restricted Stock (Carried at Cost)***

The carrying amount of investments in restricted stock approximates fair value, and considers the limited marketability of such securities.

***Accrued Interest Receivable and Payable (Carried at Cost)***

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

***Deposit Liabilities (Carried at Cost)***

The fair values disclosed for demand deposits (e.g., interest and noninterest checking, passbook savings and money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e. 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.

***Short-Term Borrowings (Carried at Cost)***

The carrying amount of short-term borrowings approximate their fair values.

***FHLB Advances (Carried at Cost)***

Fair values of FHLB advances are estimated using discounted cash flow analysis, based on quoted prices for new FHLB advances 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.

***Off-Balance Sheet Financial Instruments (Disclosed at Cost)***

Fair values for the Bank's 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 contractual amounts of unfunded commitments and letters of credit are presented in Note 15.

Mifflinburg Bancorp, Inc. & Subsidiary  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(16) FAIR VALUE MEASUREMENTS** *(cont'd)*

The estimated fair values of the Company's financial instruments were as follows at December 31, 2008 and 2007.

	2008		2007	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash and cash equivalents	\$ 6,803	\$ 6,803	\$ 8,301	\$ 8,301
Interest-bearing time deposits	1,190	1,190	992	992
Trading securities	1,835	1,835	4,258	4,258
Securities available for sale	66,708	66,708	66,576	66,576
Investments in restricted stock	1,517	1,517	1,149	1,149
Net loans	183,765	186,569	170,975	169,722
Accrued interest receivable	1,354	1,354	1,126	1,126
Mortgage servicing rights	75	75	75	75
Financial liabilities:				
Deposits	\$ 218,964	\$208,319	\$ 217,914	\$218,466
Short-term borrowings	125	125	129	129
FHLB advances	24,572	25,335	15,542	15,874
Accrued interest payable	812	812	751	751
Off-balance sheet financial instruments:				
Commitments to extend credit and letters of credit	-	-	-	-



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