SURREY BANCORP
Form 10-Q
November 14, 2011

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

for the quarterly period ended September 30, 2011

¨ **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT**

For the transition period from to

COMMISSION FILE NO. 000-50313

SURREY BANCORP

(Exact name of registrant as specified in its charter)

North Carolina	**59-3772016**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification No.)**

145 North Renfro Street, Mount Airy, NC 27030

(Address of principal executive offices)

(336) 783-3900

(Registrant s telephone number)

Check whether the registrant: (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

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

Indicate by checkmark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of large accelerated filer , accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	x

Indicate by checkmark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

State the number of shares outstanding of each of the issuer s classes of common equity, as of the latest practical date:

On November 7, 2011 there were 3,215,764 common shares issued and outstanding.

PART I FINANCIAL INFORMATION

Consolidated Balance Sheets

September 30, 2011 (Unaudited) and December 31, 2010 (Audited)

	September 2011	December 2010
Assets		
Cash and due from banks	$ 2,570,375	$ 2,398,433
Interest-bearing deposits with banks	33,791,894	22,792,088
Federal funds sold	709,646	702,121
Investment securities available for sale	2,512,078	2,012,132
Restricted equity securities	852,629	941,379
Loans, net of allowance for loan losses of $4,628,232 at September 30, 2011 and $6,683,922 at December 31, 2010	176,116,287	171,794,247
Property and equipment, net	4,632,998	4,726,483
Foreclosed assets	182,480	450,532
Accrued income	1,043,727	955,516
Goodwill	120,000	120,000
Bank owned life insurance	3,363,465	3,284,990
Other assets	3,111,630	3,474,563
Total assets	$ 229,007,209	$ 213,652,484
Liabilities and Stockholders Equity		
Liabilities		
Deposits:		
Noninterest-bearing	$ 36,568,922	$ 27,954,669
Interest-bearing	151,730,369	146,005,404
Total deposits	188,299,291	173,960,073
Long-term debt	8,100,000	9,450,000
Dividends payable	46,233	35,515
Accrued interest payable	249,132	227,887
Other liabilities	1,931,024	1,334,854
Total liabilities	198,625,680	185,008,329
Commitments and contingencies		
Stockholders equity		
Preferred stock, 1,000,000 shares authorized, 189,356 shares of Series A, issued and outstanding with no par value, 4.5% convertible non-cumulative, perpetual, with a liquidation value of $14 per share;	2,620,325	2,620,325
181,154 shares of Series D, issued and outstanding with no par value 5.0% convertible non-cumulative, perpetual; with a liquidation value of $7.08 per share;	1,248,482	1,248,482
Common stock, 10,000,000 shares authorized at no par value; 3,215,764 and 3,206,495 shares issued and outstanding at September 30, 2011 and December 31, 2010, respectively	9,500,158	9,464,178
Retained earnings	17,067,974	15,380,083
Accumulated other comprehensive loss	(55,410)	(68,913)
Total stockholders equity	30,381,529	28,644,155
Total liabilities and stockholders equity	$ 229,007,209	$ 213,652,484

See Notes to Consolidated Financial Statements

Consolidated Statements of Income

Nine months ended September 30, 2011 and 2010 (Unaudited)

	2011	2010
Interest income		
Loans and fees on loans	$ 8,138,762	$ 8,277,716
Federal funds sold	1,210	594
Investment securities, taxable	40,275	37,655
Deposits with banks	11,645	20,053
Total interest income	8,191,892	8,336,018
Interest expense		
Deposits	1,368,776	1,557,497
Short-term debt		17,720
Long-term debt	264,361	298,394
Total interest expense	1,633,137	1,873,611
Net interest income	6,558,755	6,462,407
Provision for loan losses	67,190	1,840,578
Net interest income after provision for loan losses	6,491,565	4,621,829
Noninterest income		
Service charges on deposit accounts	767,978	800,693
Gain on sale of government guaranteed loans		244,924
Fees and yield spread premiums on loans delivered to correspondents	78,865	91,511
Other service charges and fees	372,673	335,456
Other operating income	548,662	529,071
Total noninterest income	1,768,178	2,001,655
Noninterest expense		
Salaries and employee benefits	2,624,411	2,563,874
Occupancy expense	294,493	313,507
Equipment expense	179,090	192,050
Data processing	271,504	306,287
Foreclosed assets, net	140,190	23,644
Postage, printing and supplies	146,904	159,239
Professional fees	267,558	217,045
FDIC insurance premiums	176,286	184,271
Litigation settlement	130,000	
Other expense	1,075,861	950,463
Total noninterest expense	5,306,297	4,910,380
Net income before income taxes	2,953,446	1,713,104
Income tax expense	1,128,365	626,756

Net income	1,825,081	1,086,348
Preferred stock dividends and accretion of discount	(137,190)	(194,107)
Net income available to common stockholders	$ 1,687,891	$ 892,241
Basic earnings per common share	$ 0.53	$ 0.28
Diluted earnings per common share	$ 0.48	$ 0.27
Basic weighted average common shares outstanding	3,212,087	3,206,341
Diluted weighted average common shares outstanding	3,788,389	3,603,784

See Notes to Consolidated Financial Statements

Consolidated Statements of Income

Three months ended September 30, 2011 and 2010 (Unaudited)

	2011	2010
Interest income		
Loans and fees on loans	$ 2,762,166	$ 2,738,272
Federal funds sold	415	190
Investment securities, taxable	13,917	11,992
Deposits with banks	3,641	8,342
Total interest income	2,780,139	2,758,796
Interest expense		
Deposits	435,353	515,211
Short-term debt		
Long-term debt	81,461	94,931
Total interest expense	516,814	610,142
Net interest income	2,263,325	2,148,654
Provision for loan losses	188,118	636,736
Net interest income after provision for loan losses	2,075,207	1,511,918
Noninterest income		
Service charges on deposit accounts	259,093	268,216
Gain on sale of government guaranteed loans		
Fees and yield spread premiums on loans delivered to correspondents	25,247	41,774
Other service charges and fees	125,646	112,407
Other operating income	188,683	159,609
Total noninterest income	598,669	582,006
Noninterest expense		
Salaries and employee benefits	862,414	840,474
Occupancy expense	97,313	116,277
Equipment expense	58,593	55,667
Data processing	85,916	109,513
Foreclosed assets, net	(142)	7,962
Postage, printing and supplies	44,150	48,996
Professional fees	77,098	64,467
FDIC insurance premiums	36,709	65,990
Litigation settlement	130,000	
Other expense	381,421	307,179
Total noninterest expense	1,773,472	1,616,525
Net income before income taxes	900,404	477,399
Income tax expense	338,691	171,600

Net income	561,713	305,799
Preferred stock dividends and accretion of discount	(46,233)	(65,294)
Net income available to common stockholders	$ 515,480	$ 240,505
Basic earnings per common share	$ 0.16	$ 0.08
Diluted earnings per common share	$ 0.15	$ 0.08
Basic weighted average common shares outstanding	3,215,213	3,206,495
Diluted weighted average common shares outstanding	3,791,515	3,601,643

See Notes to Consolidated Financial Statements

Consolidated Statements of Cash Flows

Nine months ended September 30, 2011 and 2010 (Unaudited)

	2011	2010
Cash flows from operating activities		
Net income	$ 1,825,081	$ 1,086,348
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation and amortization	183,205	194,072
Gain on sale of property and equipment	(760)	(400)
Loss on the sale of foreclosed assets	50,254	10,695
Stock-based compensation, net of tax benefit	17,155	21,774
Provision for loan losses	67,190	1,840,578
Deferred income taxes	(6,853)	13,738
Accretion of discount on securities, net of amortization of premiums	1,526	1,958
Increase in cash surrender value of life insurance	(78,475)	(83,364)
Changes in assets and liabilities:		
Accrued income	(88,211)	54,612
Other assets	361,314	(1,216,011)
Accrued interest payable	21,245	(4,385)
Other liabilities	596,170	730,336
Net cash provided by operating activities	2,948,841	2,649,951
Cash flows from investing activities		
Net increase in interest-bearing deposits with banks	(10,999,806)	(9,525,379)
Net increase in federal funds sold	(7,525)	(41,123)
Purchases of investment securities	(2,002,500)	(2,000,000)
Sales and maturities of investment securities	1,523,003	2,007,127
Redemption of restricted equity securities	88,800	71,385
Purchase of restricted equity securities	(50)	
Net (increase) decrease in loans	(4,634,755)	5,082,011
Proceeds from the sale of foreclosed assets	463,323	68,340
Purchases of property and equipment	(89,720)	(108,105)
Proceeds from the sale of property and equipment	760	400
Net cash (used in) investing activities	(15,658,470)	(4,445,344)
Cash flows from financing activities		
Net increase in deposits	14,339,218	5,798,745
Net decrease in short-term debt		(3,750,000)
Net (decrease) increase in long-term debt	(1,350,000)	250,000
Dividends paid	(126,472)	(170,976)
Common stock options exercised	18,825	34,450
Net cash provided by financing activities	12,881,571	2,162,219
Net increase (decrease) in cash and cash equivalents	171,942	366,826
Cash and due from banks, beginning	2,398,433	1,923,621
Cash and due from banks, ending	$ 2,570,375	$ 2,290,447

Supplemental disclosures of cash flow information		
Interest paid	$ 1,611,892	$ 1,877,996
Taxes paid	$ 626,319	$ 1,246,897
Loans transferred to foreclosed properties	$ 245,525	$ 322,034

See Notes to Consolidated Financial Statements

Consolidated Statements of Changes in Stockholders Equity and Comprehensive Income

Nine months ended September 30, 2011 and 2010 (Unaudited)

	Preferred Stock Amount	Common Stock Shares	Common Stock Amount	Retained Earnings	Unrealized Appreciation (Depreciation) on Securities	Total
Balance, January 1, 2010	$ 4,626,830	3,198,105	$ 9,406,429	$ 14,468,089	$ (75,996)	$ 28,425,352
Comprehensive income						
Net income				1,086,348		1,086,348
Net change in unrealized gain (loss) on investment securities available for sale, net of income tax of $1,308					(2,085)	(2,085)
Total comprehensive income						1,084,263
Common stock options exercised		8,390	34,450			34,450
Stock-based compensation, net of tax benefit			21,774			21,774
Dividends declared on convertible Series A preferred stock ($.47 per share)				(89,226)		(89,226)
Dividends declared and accrued on Series B and Series C preferred stock, net of discount accretion and (premium) amortization	25,944			(104,881)		(81,145)
Balance, September 30, 2010	$ 4,652,774	3,206,495	$ 9,462,653	$ 15,360,330	$ (78,081)	$ 29,395,468
Balance, January 1, 2011	$ 3,868,807	3,206,495	$ 9,464,178	$ 15,380,083	$ (68,913)	$ 28,644,155
Comprehensive income						
Net income				1,825,081		1,825,081
Net change in unrealized gain (loss) on investment securities available for sale, net of income tax of $8,471					13,503	13,503
Total comprehensive income						1,838,584
Common stock options exercised, net of shares surrendered in cashless exchange		9,269	18,825			18,825
Stock-based compensation, net of tax benefit			17,155			17,155
Dividends declared on Series A convertible preferred stock ($.47 per share)				(89,225)		(89,225)
Dividends declared on Series D convertible preferred stock ($.26 per share)				(47,965)		(47,965)
Balance, September 30, 2011	$ 3,868,807	3,215,764	$ 9,500,158	$ 17,067,974	$ (55,410)	$ 30,381,529

See Notes to Consolidated Financial Statements

SURREY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

NOTE 1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements were prepared in accordance with instructions for Form 10-Q and therefore, do not include all disclosures required by generally accepted accounting principles for a complete presentation of financial statements. In the opinion of management, the consolidated financial statements contain all adjustments necessary to present fairly the financial condition of Surrey Bancorp, (the Company), as of September 30, 2011, the results of operations for the nine and three months ended September 30, 2011 and 2010, and its changes in stockholders equity and comprehensive income and cash flows for the nine months ended September 30, 2011 and 2010. The results of operations for the nine and three months ended September 30, 2011, are not necessarily indicative of the results expected for the full year. These consolidated financial statements should be read in conjunction with the Company s audited financial statements and related disclosures for the year ended December 31, 2010, included in the Company s Form 10-K. The balance sheet at December 31, 2010, has been taken from the audited financial statements at that date.

Organization

Surrey Bancorp began operation on May 1, 2003 and was created for the purpose of acquiring all the outstanding shares of common stock of Surrey Bank & Trust. Stockholders of the bank received six shares of Surrey Bancorp common stock for every five shares of Surrey Bank & Trust common stock owned. The Company is subject to regulation by the Federal Reserve.

Surrey Bank & Trust (the Bank) was organized and incorporated under the laws of the State of North Carolina on July 15, 1996 and commenced operations on July 22, 1996. The Bank currently serves Surry County, North Carolina and Patrick County, Virginia and surrounding areas through five banking offices. As a state chartered bank, which is not a member of the Federal Reserve, the Bank is subject to regulation by the State of North Carolina Banking Commission and the Federal Deposit Insurance Corporation.

Surrey Investment Services, Inc., (Subsidiary) was organized and incorporated under the laws of the State of North Carolina on February 10, 1998. The subsidiary provides insurance services through SB&T Insurance and investment advice and brokerage services through LPL Financial.

On July 31, 2000, Surrey Bank & Trust formed Freedom Finance, LLC, a subsidiary operation specializing in the purchase of sales finance contracts from local automobile dealers.

The accounting and reporting policies of the Company, the Bank, and its subsidiaries follow generally accepted accounting principles and general practices within the financial services industry. Following is a summary of the more significant policies.

Critical Accounting Policies

The notes to the audited consolidated financial statements for the year ended December 31, 2010 contain a summary of the significant accounting policies. The Company believes our policies with respect to the methodology for the determination of the allowance for loan losses, and asset impairment judgments, including the recoverability of intangible assets involve a higher degree of complexity and require management to make difficult and subjective judgments which often require assumptions or estimates about highly uncertain matters. Changes in these judgments, assumptions or estimates could cause reported results to differ materially. These critical policies and their application are periodically reviewed with the Audit Committee and our Board of Directors. See our Annual Report for full details on critical accounting policies.

Principles of Consolidation

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

SURREY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. BASIS OF PRESENTATION, CONTINUED

Presentation of Cash Flows

For purposes of reporting cash flows, cash and cash equivalents includes cash and amounts due from depository institutions (including cash items in process of collection). Overnight interest bearing deposits and federal funds sold are shown separately. Federal funds purchased are shown with securities sold under agreements to repurchase.

Investment Securities

Investments classified as available for sale are intended to be held for indefinite periods of time and include those securities that management may employ as part of asset/liability strategy or that may be sold in response to changes in interest rates, prepayments, regulatory capital requirements or similar factors. These securities are carried at fair value and are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments or significant other observable inputs.

Investment securities classified as held to maturity are those debt securities that the Bank has the ability and intent to hold to maturity. Accordingly, these securities are carried at cost adjusted for amortization of premiums and accretion of discount, computed by the interest-method over their contractual lives. At September 30, 2011 and December 31, 2010, the Bank had no investments classified as held to maturity.

Loans Held for Sale

The Bank originates and holds Small Business Administration (SBA) and United States Department of Agriculture (USDA) guaranteed loans in its portfolio in the normal course of business. Occasionally, the Bank sells the guaranteed portions of these loans into the secondary market. The loans are generally variable rate loans, which eliminates the market risk to the Bank and are therefore carried at cost. The Bank recognizes gains on the sale of the guaranteed portion upon the consummation of the transaction. The Bank plans to continue to originate guaranteed loans for sales, however no such loans were funded at September 30, 2011 and December 31, 2010.

Loans Receivable

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding principal amount adjusted for any charge-offs, the allowance for loan losses, and any deferred fees or cost on originated loans and unamortized premiums or discounts on purchased loans.

Loan origination fees and certain direct origination costs are capitalized and recognized as an adjustment of the yield of the related loan using the interest method. Discounts and premiums on any purchased residential real estate loans are amortized to income using the interest method over the remaining period to contractual maturity, adjusted for anticipated prepayments. Discounts and premiums on any purchased consumer loans are recognized over the expected lives of the loans using methods that approximate the interest method.

Interest is accrued and credited to income based on the principal amount outstanding. The accrual of interest on impaired loans is discontinued when, in management s opinion, the borrower may be unable to meet payments as they become due. When the interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received. Payments received on nonaccrual loans are first applied to principal and any residual amounts are then applied to interest. When facts and circumstances indicate the borrower has regained the ability to meet the required payments, the loan is returned to accrual status. Past due loans are determined on the basis of contractual terms.

SURREY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. BASIS OF PRESENTATION, CONTINUED

Allowance for Loan Losses

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

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

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

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

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

Recent Accounting Pronouncements

The following is a summary of recent authoritative pronouncements:

In July 2010, the Receivables topic of the Accounting Standards Codification (ASC) was amended by Accounting Standards Update (ASU) 2010-20 to require expanded disclosures related to a company s allowance for credit losses and the credit quality of its financing receivables. The amendments require the allowance disclosures to be provided on a disaggregated basis. The Company is required to include these disclosures in its interim and annual financial statements. See Note 6.

Disclosures about Troubled Debt Restructurings (TDRs) required by ASU 2010-20 were deferred by the Financial Accounting Standards Board (FASB) in ASU 2011-01 issued in January 2011. In April 2011 the FASB issued ASU 2011-02 to assist creditors with their determination of when a restructuring is a TDR. The determination is based on whether the restructuring constitutes a concession and whether the debtor is experiencing financial difficulties as both events must be present.

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SURREY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. BASIS OF PRESENTATION, CONTINUED

Recent Accounting Pronouncements, continued

Disclosures related to TDRs under ASU 2010-20 have been presented in Note 7.

In December 2010, the Intangibles topic of the ASC was amended to modify Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. Any resulting goodwill impairment should be recorded as a cumulative-effect adjustment to beginning retained earnings upon adoption. Impairments occurring subsequent to adoption should be included in earnings. The amendment was effective for the Company beginning January 1, 2011.

In September 2011, the Intangibles topic was again amended to permit an entity to consider qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. These amendments will be effective for the Company on January 1, 2012.

In April 2011, the criteria used to determine effective control of transferred assets in the Transfers and Servicing topic of the ASC was amended by ASU 2011-03. The requirement for the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms and the collateral maintenance implementation guidance related to that criterion were removed from the assessment of effective control. The other criteria to assess effective control were not changed. The amendments are effective for the Company beginning January 1, 2012 but are not expected to have a material effect on the financial statements.

ASU 2011-04 was issued in May 2011 to amend the Fair Value Measurement topic of the ASC by clarifying the application of existing fair value measurement and disclosure requirements and by changing particular principles or requirements for measuring fair value or for disclosing information about fair value measurements. The amendments will be effective for the Company beginning January 1, 2012 but are not expected to have a material effect on the financial statements.

The Comprehensive Income topic of the ASC was amended in June 2011. The amendment eliminates the option to present other comprehensive income as a part of the statement of changes in stockholders equity. The amendment requires consecutive presentation of the statement of net income and other comprehensive income and requires an entity to present reclassification adjustments from other comprehensive income to net income on the face of the financial statements. The amendments will be applicable to the Company on January 1, 2012 and will be applied retrospectively.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a material impact on the Company s financial position, results of operations or cash flows.

Subsequent Events

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Non-recognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date. Management has reviewed events occurring through the date the financial statements were issued and no subsequent events have occurred requiring accrual or disclosure.

SURREY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2. SECURITIES

Debt and equity securities have been classified in the balance sheets according to management s intent. The amortized costs of securities available for sale and their approximate fair values at September 30, 2011 and December 31, 2010 follow:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
September 30, 2011				
Government-sponsored enterprises	$ 2,001,016	$ 8,679	$	$ 2,009,695
Mortgage-backed securities	51,232	1,526		52,758
Corporate bonds	550,000		100,375	449,625
	$ 2,602,248	$ 10,205	$ 100,375	$ 2,512,078
December 31, 2010				
Government-sponsored enterprises	$ 1,500,000	$ 1,770	$	$ 1,501,770
Mortgage-backed securities	74,278	1,584		75,862
Corporate bonds	550,000		115,500	434,500
	$ 2,124,278	$ 3,354	$ 115,500	$ 2,012,132

At September 30, 2011 and December 31, 2010, substantially all government-sponsored enterprises securities were pledged as collateral on public deposits and for other purposes as required or permitted by law. The mortgage-backed securities were pledged to the Federal Home Loan Bank.

Maturities of mortgage-backed bonds are stated based on contractual maturities. Actual maturities of these bonds may vary as the underlying mortgages are prepaid. The scheduled maturities of securities (all available for sale) at September 30, 2011, were as follows:

	Amortized Cost	Fair Value
Due in one year or less	$	$
Due after one year through five years	2,001,016	2,009,695
Due after five years through ten years	586,895	487,542
Due after ten years	14,337	14,841
	$ 2,602,248	$ 2,512,078

The following table shows investments gross unrealized losses and fair value, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position, at September 30, 2011 and December 31, 2010. These unrealized losses on investment securities are a result of volatility in interest rates and primarily relate to corporate bonds issued by other banks at September 30, 2011 and December 31, 2010.

	Less Than 12 Months		12 Months or More		Total	
	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized

	Value	Losses	Value	Losses	Value	Losses
September 30, 2011						
Corporate bonds	$	$	$ 449,625	$ 100,375	$ 449,625	$ 100,375
	$	$	$ 449,625	$ 100,375	$ 449,625	$ 100,375
December 31, 2010						
Corporate bonds	$	$	$ 434,500	$ 115,500	$ 434,500	$ 115,500
	$	$	$ 434,500	$ 115,500	$ 434,500	$ 115,500

SURREY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2. SECURITIES, CONTINUED

Management considers the nature of the investment, the underlying causes of the decline in the market value and the severity and duration of the decline in market value in determining if impairment is other than temporary. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Based upon this evaluation, there are two securities in the portfolio with unrealized losses for a period greater than 12 months. We have analyzed each individual security for Other Than Temporary Impairment (OTTI) purposes by reviewing delinquencies, loan-to-value ratios, and credit quality and concluded that all unrealized losses presented in the tables above are not related to an issuer s financial condition but are due to changes in the level of interest rates and no declines are deemed to be other than temporary in nature.

The Company had no gross realized gains or losses from the sales of investment securities for the nine and three month periods ended September 30, 2011 and 2010.

NOTE 3. EARNINGS PER SHARE

Basic earnings per share for the nine and three months ended September 30, 2011 and 2010 were calculated by dividing net income available to common stockholders by the weighted average number of shares outstanding during the period.

The computation of diluted earnings per share is similar to the computation of basic earnings per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if dilutive potential common shares had been issued. The numerator is adjusted for any changes in income or loss that would result from the assumed conversion of those potential common shares. The potential dilutive shares are represented by common stock options and by the Series A and D convertible preferred stock. Each share of the Series A preferred is convertible into 2.0868 shares of common stock. Each share of Series D preferred is convertible into one share of common stock.

NOTE 4. COMMITMENTS AND LETTERS OF CREDIT

At September 30, 2011, the Company had commitments to extend credit, including unused lines of credit of approximately $36,414,000. Letters of credit totaling $1,349,531 were outstanding.

NOTE 5. LOANS

The major components of loans in the balance sheets at September 30, 2011 and December 31, 2010 are below.

	2011	2010
Commercial	$ 71,722,630	$ 66,377,076
Real estate:		
Construction and land development	5,253,339	5,986,045
Residential, 1-4 families	41,806,459	46,356,711
Residential, 5 or more families	2,259,445	1,853,346
Farmland	2,903,144	2,854,481
Nonfarm, nonresidential	49,721,494	48,170,698
Agricultural	43,263	73,852
Consumer, net of discounts of $21,169 in 2011 and $14,770 in 2010	7,013,836	6,759,770
	180,723,610	178,431,979
Deferred loan origination costs, net of fees	20,909	46,190

	180,744,519	178,478,169
Allowance for loan losses	(4,628,232)	(6,683,922)
	$ 176,116,287	$ 171,794,247

SURREY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5. LOANS, CONTINUED

Residential, 1-4 family loans pledged as collateral against FHLB advances approximated $20,483,000 and $25,141,000 at September 30, 2011 and December 31, 2010.

NOTE 6. ALLOWANCE FOR LOAN LOSSES

The activity of the allowance for loan losses by loan components at September 30, 2011 and 2010 was as follows:

	Construction & Development	1-4 Family Residential	Nonfarm, Nonresidential	Commercial & Industrial	Consumer	Other	Total
2011							
Allowance for credit losses:							
Beginning balance	$ 118,797	$ 1,696,068	$ 1,199,292	$ 3,411,403	$ 205,662	$ 52,700	$ 6,683,922
Charge-offs	(27,468)	(1,113,243)	(203,418)	(1,007,729)	(45,010)		(2,396,868)
Recoveries	996	56,241	108,114	83,804	24,833		273,988
Provision	3,621	185,093	(233,826)	77,669	29,233	5,400	67,190
Ending balance	$ 95,946	$ 824,159	$ 870,162	$ 2,565,147	$ 214,718	$ 58,100	$ 4,628,232
Ending balance: individually evaluated for impairment	$ 146	$ 156,159	$ 277,262	$ 1,447,747	$	$	$ 1,881,314
Ending balance: collectively evaluated for impairment	$ 95,800	$ 668,000	$ 592,900	$ 1,117,400	$ 214,718	$ 58,100	$ 2,746,918
Ending balance: loans acquired with deteriorated credit quality	$	$	$	$	$	$	$
Loans Receivable:							
Ending balance	$ 5,253,339	$ 41,806,459	$ 49,721,494	$ 71,722,630	$ 7,013,836	$ 5,205,852	$ 180,723,610
Ending balance: individually evaluated for impairment	$ 93,385	$ 949,971	$ 4,054,573	$ 6,338,214	$ 5,475	$	$ 11,441,618
Ending balance: collectively evaluated for impairment	$ 5,159,954	$ 40,856,488	$ 45,666,921	$ 65,384,416	$ 7,008,361	$ 5,205,852	$ 169,281,992
Ending balance: loans acquired with deteriorated credit quality	$	$	$	$	$	$	$
2010							
Allowance for credit losses:							
Beginning balance	$ 106,397	$ 628,963	$ 696,044	$ 2,903,267	$ 281,134	$ 54,100	$ 4,669,905

Charge-offs		(26,748)	(109,948)	(545,752)	(92,774)		(775,222)
Recoveries		950	20,501	368	25,789		47,608
Provision	(25,800)	161,128	100,831	1,573,613	35,606	(4,800)	1,840,578
Ending balance	$ 80,597	$ 764,293	$ 707,428	$ 3,931,496	$ 249,755	$ 49,300	$ 5,782,869
Ending balance: individually evaluated for impairment	$ 12,097	$ 198,093	$ 120,928	$ 3,049,496	$	$	$ 3,380,614
Ending balance: collectively evaluated for impairment	$ 68,500	$ 566,200	$ 586,500	$ 882,000	$ 249,755	$ 49,300	$ 2,402,255
Ending balance: loans acquired with deteriorated credit quality	$	$	$	$	$	$	$
Loans Receivable:							
Ending balance	$ 5,790,613	$ 47,054,360	$ 47,351,314	$ 67,199,483	$ 6,977,325	$ 4,538,213	$ 178,911,308
Ending balance: individually evaluated for impairment	$ 56,363	$ 703,762	$ 712,351	$ 6,104,973	$ 3,301	$	$ 7,580,750
Ending balance: collectively evaluated for impairment	$ 5,734,250	$ 46,350,598	$ 46,638,963	$ 61,094,510	$ 6,974,024	$ 4,538,213	$ 171,330,558
Ending balance: loans acquired with deteriorated credit quality	$	$	$	$	$	$	$

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6. ALLOWANCE FOR LOAN LOSSES, CONTINUED

The following table presents impaired loans individually evaluated by class of loan as of September 30, 2011 and December 31, 2010:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
September 30, 2011					
With no related allowance recorded:					
Construction and development	$ 77,213	$ 77,213	$	$ 78,049	$
1-4 family residential	387,371	445,185		396,325	3,713
Nonfarm, nonresidential	2,426,530	2,589,261		2,434,737	68,967
Commercial and industrial	2,081,475	2,255,962		2,184,723	77,625
Consumer	5,475	5,475		5,475	
Other loans					
	4,978,064	5,373,096		5,099,309	150,305
With an allowance recorded:					
Construction and development	$ 16,172	$ 16,172	$ 146	$ 16,453	$
1-4 family residential	562,600	589,965	156,159	557,367	10,624
Nonfarm, nonresidential	1,628,043	1,628,043	277,262	1,638,660	8,004
Commercial and industrial	4,256,739	4,256,739	1,447,747	4,672,517	106,814
Consumer					
Other loans					
	6,463,554	6,490,919	1,881,314	6,884,997	125,442
Combined:					
Construction and development	$ 93,385	$ 93,385	$ 146	$ 94,502	$
1-4 family residential	949,971	1,035,150	156,159	953,692	14,337
Nonfarm, nonresidential	4,054,573	4,217,304	277,262	4,073,397	76,971
Commercial and industrial	6,338,214	6,512,701	1,447,747	6,857,240	184,439
Consumer	5,475	5,475		5,475	
Other loans					
	$ 11,441,618	$ 11,864,015	$ 1,881,314	$ 11,984,306	$ 275,747
December 31, 2010					
With no related allowance recorded:					
Construction and development	$ 97,436	$ 97,436	$	$ 173,163	$ 5,758
1-4 family residential	931,920	931,920		938,365	55,516
Nonfarm, nonresidential	2,098,860	2,098,860		2,136,591	110,297
Commercial and industrial	2,246,985	2,246,985		2,289,276	123,804
Consumer	10,439	10,439		10,439	
Other loans					

5,385,640&nbs