

BAR HARBOR BANKSHARES  
Form 10-K/A  
September 17, 2014

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**  
**FORM 10-K/A**  
**(Amendment No. 1)**

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

**For the fiscal year ended December 31, 2013**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_.**

*Commission File Number: 001-13349*

**BAR HARBOR BANKSHARES**

*(Exact name of registrant as specified in its charter)*

**Maine**

*(State or other jurisdiction of  
incorporation or organization)*

**P.O. Box 400, 82 Main Street**

**Bar Harbor, Maine**

*(Address of principal executive offices)*

**04609-0400**

*(Zip Code)*

**01-0393663**

*(I.R.S. Employer  
Identification No.)*

**(207) 288-3314**

*(Registrant's telephone number,*

*including area code)*

**Securities registered pursuant to Section 12(b) of the Act:**

Title of class

Name of exchange on which registered

**Common Stock, \$2.00 par value per share**

**NYSE MKT, LLC**

**Securities registered pursuant to Section 12(g) of the Act: None**

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act: YES  NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act: YES  NO

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days: YES  NO

Indicate by checkmark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES  NO

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): YES  NO

The aggregate market value of the common stock held by non-affiliates of Bar Harbor Bankshares was \$139,069,826 based on the closing sale price of the common stock on the NYSE MKT on June 28, 2013, the last trading day of the registrant's most recently completed second quarter.

Number of shares of Common Stock par value \$2.00 outstanding as of March 3, 2014: **3,940,790**

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the definitive Proxy Statement for the Annual Meeting of Stockholders to be held on May 20, 2014 are incorporated by reference into Part III, Items 10-14 of this Annual Report on Form 10-K.

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**EXPLANATORY NOTE**

The purpose of this Amendment No. 1 on Form 10-K/A (the Amendment) to the Annual Report on Form 10-K for the year ended December 31, 2013 of Bar Harbor Bankshares (the Company), originally filed with the Securities and Exchange Commission on March 13, 2014 (the Form 10-K), is to:

(A) amend Part II, Item 8, REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM, on page 72 of the Form 10-K to insert "(1992)" immediately following the words, *Internal Control Integrated Framework*", to indicate that in conducting the 2013 audit of the Company's internal controls over financial reporting Committee of Sponsoring Organizations of the Treadway Commission (COSO) 1992 framework was used;

(B) amend Part II, Item 8, REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM, on page 72 of the Form 10-K to change the date of the "REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM" from March 12, 2014 to March 13, 2014. This change corrects an error that occurred due to filing the Company's Form 10-K on March 13, 2014 rather than March 12, 2014;

(C) amend Part II, Item 9A, *Management Report on Internal Control over Financial Reporting*, on page 121 of the Form 10-K, to insert "(1992)" immediately following the words, *Internal Control Integrated Framework*", to indicate that in conducting the 2013 audit of the Company's internal controls over financial reporting the Committee of Sponsoring Organizations of the Treadway Commission (COSO) 1992 framework was used;

(D) amend Part II, Item 9A, *Management Report on Internal Control over Financial Reporting*, on page 121 of the Form 10-K, to insert "(1992)" immediately following the words, "Based on its assessment, management believes that as of December 31, 2013, the Company's internal control over financial reporting is effective, based on the criteria set forth by COSO in *Internal Control Integrated Framework*", to indicate that in conducting management's assessment of the effectiveness of the Company's internal controls over financial reporting, the Committee of Sponsoring Organizations of the Treadway Commission (COSO) 1992 framework was used; and

(E) amend Part II, Item 9A, REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM on page 122 of the Form 10-K, to insert "(1992)" immediately following the words, "*Internal Control Integrated Framework*", to indicate that in conducting the auditor's assessment of the effectiveness of the Company's internal controls over financial reporting, the Committee of Sponsoring Organizations of the Treadway Commission (COSO) 1992 framework was used; and

(F) amend Part II, Item 9A, REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM, on page 122 to change the date at the bottom of the report from March 12, 2014 to March 13, 2014. This change corrects an error that occurred due to filing of the Company's Form 10-K on March 13, 2014 rather than March 12, 2014; and

As required by Rule 12b-15, the Company's principal executive officer and principal financial officer are providing currently dated certifications on Exhibits 31.1, 31.2, 32.1 and 32.2. Accordingly, the Company hereby further amends Item 15 of the Form 10-K to add such reports as exhibits.

Except as described above, the Amendment does not modify or update any other items or disclosures contained in the Form 10-K. The disclosures contained in the Form 10-K have not been updated to reflect events, results or developments that have occurred after March 13, 2014, or to modify or update those disclosures affected by

subsequent events. This Amendment should be read in conjunction with the Company's other filings with the Securities and Exchange Commission, together with any amendments to those filings.

**PART II**

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Shareholders

Bar Harbor Bankshares:

We have audited the accompanying consolidated balance sheets of Bar Harbor Bankshares and subsidiaries (the Company) as of December 31, 2013 and 2012, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2013. 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 the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Bar Harbor Bankshares and subsidiaries as of December 31, 2013 and 2012, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2013, in conformity with U. S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2013, based on criteria established in *Internal Control - Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 13, 2014 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP

Boston, Massachusetts

March 13, 2014



**BAR HARBOR BANKSHARES AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****DECEMBER 31, 2013 AND 2012****(in thousands, except share and per share data)**

|  | <b>December 31,</b> | <b>December 31,</b> |
|--|---------------------|---------------------|
|  | <b>2013</b>         | <b>2012</b>         |
| <b>Assets</b>  |                     |                     |
| Cash and cash equivalents  | \$ 9,200            | \$ 14,992           |
| Securities available for sale, at fair value (amortized cost of<br>\$461,635 and \$405,769, respectively)                                      | 450,170             | 418,040             |
| Federal Home Loan Bank stock   | 18,370              | 18,189              |
| Loans  | 852,857             | 815,004             |
| Allowance for loan losses  | (8,475)             | (8,097)             |
| Loans, net of allowance for loan losses  | 844,382             | 806,907             |
| Premises and equipment, net  | 20,145              | 19,255              |
| Goodwill   | 4,935               | 4,935               |
| Bank owned life insurance  | 7,879               | 7,633               |
| Other assets   | 18,812              | 12,984              |
| <b>TOTAL ASSETS</b>  | <b>\$1,373,893</b>  | <b>\$1,302,935</b>  |
| <b>Liabilities</b>   |                     |                     |
| Deposits:  |                     |                     |
| Demand and other non-interest bearing deposits   | \$ 72,259           | \$ 71,865           |
| NOW accounts   | 135,246             | 123,015             |
| Savings and money market deposits  | 232,558             | 230,325             |
| Time deposits  | 395,588             | 370,560             |
| Total deposits   | 835,651             | 795,765             |
| Short-term borrowings  | 312,945             | 224,077             |
| Long-term advances from Federal Home Loan Bank   | 91,500              | 142,490             |
| Junior subordinated debentures   | 5,000               | 5,000               |
| Other liabilities  | 7,418               | 7,557               |
| <b>TOTAL LIABILITIES</b>   | <b>1,252,514</b>    | <b>1,174,889</b>    |
| <b>Shareholders' equity</b>  |                     |                     |
| Capital stock, par value \$2.00; authorized 10,000,000 shares;   |                     |                     |
| issued 4,525,635 shares at December 31, 2013 and December 31, 2012   | 9,051               | 9,051               |
| Surplus  | 26,845              | 26,693              |
| Retained earnings  | 102,147             | 93,900              |
| Accumulated other comprehensive (loss) income:   |                     |                     |
| Prior service cost and unamortized net actuarial losses on employee<br>benefit plans, net of tax of (\$192) and (\$207), at December 31, 2013, | (373)               | (401)               |

and December 31, 2012, respectively

Net unrealized (depreciation) appreciation on securities available for sale,

net of tax of (\$4,150) and \$4,099, at December 31, 2013 and

|   |             |             |
|---|-------------|-------------|
| December 31, 2012, respectively                                       | (8,055)     | 7,954       |
| Portion of OTTI attributable to non-credit gains, net of tax of \$252 |             |             |
| and \$74, at December 31, 2013, and December 31, 2012, respectively   | 488         | 144         |
| Total accumulated other comprehensive (loss) income                   | (7,940)     | 7,697       |
| Less: cost of 586,560 and 605,591 shares of treasury stock at         |             |             |
| December 31, 2013 and December 31, 2012, respectively                 | (8,724)     | (9,295)     |
| TOTAL SHAREHOLDERS' EQUITY  | 121,379     | 128,046     |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY                            | \$1,373,893 | \$1,302,935 |

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

**BAR HARBOR BANKSHARES AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME****YEARS ENDED DECEMBER 31, 2013, 2012 AND 2011****(in thousands, except share and per share data)**

|   | <b>2013</b> | <b>2012</b> | <b>2011</b> |
|---|-------------|-------------|-------------|
| Interest and dividend income:                         |             |             |             |
| Interest and fees on loans                            | \$ 37,223   | \$ 36,579   | \$ 34,854   |
| Interest on securities                                | 13,457      | 14,173      | 16,006      |
| Dividends on FHLB stock                               | 69          | 86          | 47          |
| Total interest and dividend income                    | 50,749      | 50,838      | 50,907      |
| Interest expense:                                     |             |             |             |
| Deposits  | 6,616       | 7,707       | 8,765       |
| Short-term borrowings                                 | 487         | 436         | 260         |
| Long-term debt  | 4,560       | 5,724       | 7,493       |
| Total interest expense                                | 11,663      | 13,867      | 16,518      |
| Net interest income                                   | 39,086      | 36,971      | 34,389      |
| Provision for loan losses                             | 1,418       | 1,652       | 2,395       |
| Net interest income after provision for loan losses   | 37,668      | 35,319      | 31,994      |
| Non-interest income:                                  |             |             |             |
| Trust and other financial services                    | 3,634       | 3,278       | 3,061       |
| Service charges on deposit accounts                   | 1,248       | 1,196       | 1,284       |
| Credit and debit card service charges and fees        | 1,572       | 1,462       | 1,277       |
| Net securities gains                                  | 676         | 1,938       | 2,689       |
| Total other-than-temporary impairment ("OTTI") losses | (359)       | (1,170)     | (2,796)     |
| Non-credit portion of OTTI losses (before taxes) (1)  | 110         | 317         | 577         |
| Net OTTI losses recognized in earnings                | (249)       | (853)       | (2,219)     |
| Other operating income                                | 685         | 688         | 700         |
| Total non-interest income                             | 7,566       | 7,709       | 6,792       |
| Non-interest expense:                                 |             |             |             |
| Salaries and employee benefits                        | 15,227      | 14,027      | 12,814      |
| Occupancy expense                                     | 1,968       | 1,682       | 1,514       |
| Furniture and equipment expense                       | 2,005       | 1,778       | 1,660       |
| Credit and debit card expenses                        | 384         | 367         | 310         |
| FDIC insurance assessments                            | 696         | 853         | 1,099       |
| Other operating expense                               | 6,580       | 6,911       | 5,884       |
| Total non-interest expense                            | 26,860      | 25,618      | 23,281      |
| Income before income taxes                            | 18,374      | 17,410      | 15,505      |
| Income taxes  | 5,191       | 4,944       | 4,462       |
| Net income  | \$ 13,183   | \$ 12,466   | \$ 11,043   |

**Computation of Earnings Per Share:**

|   |           |           |           |  |
|---|-----------|-----------|-----------|--|
| Weighted average number of capital stock shares outstanding |           |           |           |  |
| Basic   | 3,932,051 | 3,901,118 | 3,860,474 |  |
| Effect of dilutive employee stock options                   | 20,242    | 18,651    | 18,140    |  |
| Diluted   | 3,952,293 | 3,919,769 | 3,878,614 |  |

**Per Common Share Data:**

|                            |    |      |    |      |    |      |
|----------------------------|----|------|----|------|----|------|
| Basic Earnings Per Share   | \$ | 3.35 | \$ | 3.20 | \$ | 2.86 |
| Diluted Earnings Per Share | \$ | 3.34 | \$ | 3.18 | \$ | 2.85 |

(1) Included in other comprehensive income, net of taxes

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

**BAR HARBOR BANKSHARES AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****FOR THE YEARS ENDED DECEMBER 31, 2013, 2012 AND 2011****(in thousands)**

|   | <b>Years Ended</b>  |             |             |
|---|---------------------|-------------|-------------|
|   | <b>December 31,</b> |             |             |
|   | <b>2013</b>         | <b>2012</b> | <b>2011</b> |
| Net income  | \$ 13,183           | \$12,466    | \$11,043    |
| Other comprehensive income:   |                     |             |             |
| Net unrealized (depreciation) appreciation on securities available for sale,                                    |                     |             |             |
| net of tax of (\$7,926), \$915 and \$3,612, respectively  | (15,383)            | 1,773       | 7,012       |
| Less reclassification adjustment for net gains related to securities available for sale included in net income, |                     |             |             |
| net of tax of (\$230), (\$658) and (\$914), respectively  | (446)               | (1,279)     | (1,775)     |
| Add other-than-temporary impairment adjustment,   |                     |             |             |
| net of tax of \$122, \$398 and \$950, respectively  | 237                 | 772         | 1,845       |
| Less non-credit portion of other-than-temporary impairment losses,  |                     |             |             |
| net of tax of (\$37), (\$108) , and (\$196), respectively   | (73)                | (209)       | (381)       |
| Net amortization of prior service cost and actuarial gain for supplemental executive retirement plan,           |                     |             |             |
| net of related tax of (\$36), (\$47) and \$1, respectively  | (69)                | (92)        | 2           |
| Actuarial gain (loss) on supplemental executive retirement plan,  |                     |             |             |
| net of related tax of \$51, ( \$151) and \$19, respectively   | 97                  | (292)       | 37          |
| Total other comprehensive (loss) income   | (15,637)            | 673         | 6,740       |
| Total comprehensive (loss) income   | \$ (2,454)          | \$13,139    | \$17,783    |

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





## BAR HARBOR BANKSHARES AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

YEARS ENDED DECEMBER 31, 2013, 2012 AND 2011

(in thousands, except share and per share data)

|  | Accumulated |          |                      |                                      |            |                   |                         |
|--|-------------|----------|----------------------|--------------------------------------|------------|-------------------|-------------------------|
|  | Capital     |          | Retained<br>Earnings | Other Comprehensive<br>income (loss) |            | Treasury<br>Stock | Shareholders'<br>Equity |
|  | Stock       | Surplus  |                      | Stock                                | Stock      |                   |                         |
| <b>Balance December 31, 2010</b>           | \$ 9,051    | \$26,165 | \$ 80,379            | \$ 284                               | \$(12,271) | \$103,608         |                         |
| Net income                                 | ---         | ---      | 11,043               | ---                                  | ---        | 11,043            |                         |
| Total other comprehensive income           | ---         | ---      | ---                  | 6,740                                | ---        | 6,740             |                         |
| Dividend declared:                         |             |          |                      |                                      |            |                   |                         |
| Common stock (\$1.095 per share)           | ---         | ---      | (4,228)              | ---                                  | ---        | (4,228)           |                         |
| Purchase of treasury stock (22,087 shares) | ---         | ---      | ---                  | ---                                  | (623)      | (623)             |                         |
| Stock options exercised (78,035 shares),   |             |          |                      |                                      |            |                   |                         |
| including related tax effects              | ---         | 248      | (996)                | ---                                  | 2,359      | 1,611             |                         |
| Recognition of stock based                 |             |          |                      |                                      |            |                   |                         |
| compensation expense                       | ---         | 99       | ---                  | ---                                  | ---        | 99                |                         |
| <b>Balance December 31, 2011</b>           | \$9,051     | \$26,512 | \$ 86,198            | \$ 7,024                             | \$(10,535) | \$118,250         |                         |
| <b>Balance December 31, 2011</b>           | \$9,051     | \$26,512 | \$ 86,198            | \$ 7,024                             | \$(10,535) | \$118,250         |                         |
| Net income                                 | ---         | ---      | 12,466               | ---                                  | ---        | 12,466            |                         |
| Total other comprehensive income           | ---         | ---      | ---                  | 673                                  | ---        | 673               |                         |
| Dividend declared:                         |             |          |                      |                                      |            |                   |                         |
| Common stock (\$1.170 per share)           | ---         | ---      | (4,565)              | ---                                  | ---        | (4,565)           |                         |
| Purchase of treasury stock (5,383 shares)  | ---         | ---      | ---                  | ---                                  | (181)      | (181)             |                         |
| Stock options exercised (45,154 shares),   |             |          |                      |                                      |            |                   |                         |
| including related tax effects              | ---         | 35       | (228)                | ---                                  | 1,380      | 1,187             |                         |
| Recognition of stock based                 |             |          |                      |                                      |            |                   |                         |
| compensation expense                       | ---         | 195      | 21                   | ---                                  | ---        | 216               |                         |
| Restricted stock grants (1,380 shares)     | ---         | (49)     | 8                    | ---                                  | 41         | ---               |                         |



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|  |         |          |           |            |            |           |
|--|---------|----------|-----------|------------|------------|-----------|
| <b>Balance December 31, 2012</b>         | \$9,051 | \$26,693 | \$ 93,900 | \$ 7,697   | \$ (9,295) | \$128,046 |
| <b>Balance December 31, 2012</b>         | \$9,051 | \$26,693 | \$ 93,900 | \$ 7,697   | \$ (9,295) | \$128,046 |
| Net income                               | ---     | ---      | 13,183    | ---        | ---        | 13,183    |
| Total other comprehensive loss           | ---     | ---      | ---       | (15,637)   | ---        | (15,637)  |
| Dividend declared:                       |         |          |           |            |            |           |
| Common stock (\$1.250 per share)         | ---     | ---      | (4,915)   | ---        | ---        | (4,915)   |
| Purchase of treasury stock (700 shares)  | ---     | ---      | ---       | ---        | (24)       | (24)      |
| Stock options exercised (16,361 shares), |         |          |           |            |            |           |
| including related tax effects            | ---     | 19       | (49)      | ---        | 491        | 461       |
| Recognition of stock based               |         |          |           |            |            |           |
| compensation expense                     | ---     | 254      | 11        | ---        | ---        | 265       |
| Restricted stock grants (3,370 shares)   | ---     | (121)    | 17        | ---        | 104        | ---       |
| <b>Balance December 31, 2013</b>         | \$9,051 | \$26,845 | \$102,147 | \$ (7,940) | \$ (8,724) | \$121,379 |

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



**BAR HARBOR BANKSHARES AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS****YEARS ENDED DECEMBER 31, 2013, 2012 AND 2011****(in thousands)**

|  | <b>2013</b> | <b>2012</b> | <b>2011</b> |
|--|-------------|-------------|-------------|
| Cash flows from operating activities:  |             |             |             |
| Net income   | \$ 13,183   | \$ 12,466   | \$ 11,043   |
| Adjustments to reconcile net income to net cash provided by operating activities:              |             |             |             |
| Depreciation and amortization of premises and equipment  | 1,504       | 1,292       | 1,180       |
| Amortization of core deposit intangible  | 92          | 36          | ---         |
| Provision for loan losses  | 1,418       | 1,652       | 2,395       |
| Net securities gains   | (676)       | (1,938)     | (2,689)     |
| Other-than-temporary impairment  | 249         | 853         | 2,219       |
| Net amortization of bond premiums and discounts  | 5,076       | 4,133       | 1,636       |
| Deferred tax benefit   | (111)       | (83)        | (477)       |
| Recognition of stock based expense   | 265         | 216         | 99          |
| Gains on sale of other real estate owned   | (53)        | (37)        | (20)        |
| Net change in other assets   | 752         | 711         | 147         |
| Net change in other liabilities  | (139)       | 1,790       | 606         |
| Net cash provided by operating activities  | 21,560      | 21,091      | 16,139      |
| Cash flows from investing activities:  |             |             |             |
| Net cash received in acquisition   | ---         | 1,197       | ---         |
| Purchases of securities available for sale   | (172,131)   | (167,358)   | (137,215)   |
| Proceeds from maturities, calls and principal pay downs of mortgage-backed securities          | 94,382      | 93,984      | 73,737      |
| Proceeds from sales of securities available for sale   | 17,234      | 39,304      | 48,468      |
| Net increase in Federal Home Loan Bank stock   | (181)       | (1,351)     | ---         |
| Net loans made to customers  | (38,632)    | (55,083)    | (33,217)    |
| Proceeds from sale of other real estate owned  | 1,084       | 831         | 167         |
| Capital expenditures   | (2,394)     | (3,894)     | (3,765)     |
| Net cash used in investing activities  | (100,638)   | (92,370)    | (51,825)    |
| Cash flows from financing activities:  |             |             |             |
| Net increase in deposits   | 39,886      | 33,602      | 14,562      |
| Net increase (decrease) in securities sold under repurchase agreements and fed funds purchased | (381)       | (3,992)     | (5,679)     |
| Proceeds from Federal Home Loan Bank advances  | 82,900      | 90,796      | 84,000      |
| Repayments of Federal Home Loan Bank advances  | (44,641)    | (39,296)    | (58,052)    |
| Purchases of Treasury Stock  | (24)        | (181)       | (623)       |
| Proceeds from stock option exercises, including excess tax benefits                            | 461         | 1,187       | 1,611       |

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|  |           |           |           |
|--|-----------|-----------|-----------|
| Payments of dividends                                | (4,915)   | (4,565)   | (4,228)   |
| Net cash provided by financing activities            | 73,286    | 77,551    | 31,591    |
| Net (decrease) increase in cash and cash equivalents | (5,792)   | 6,272     | (4,095)   |
| Cash and cash equivalents at beginning of period     | 14,992    | 8,720     | 12,815    |
| Cash and cash equivalents at end of period           | \$ 9,200  | \$ 14,992 | \$ 8,720  |
| Supplemental disclosures of cash flow information:   |           |           |           |
| Cash paid during the period for:                     |           |           |           |
| Interest   | \$ 11,833 | \$ 14,011 | \$ 16,768 |
| Income taxes   | 4,514     | 4,323     | 5,087     |
| Schedule of noncash investing activities:            |           |           |           |
| Transfers from loans to other real estate owned      | \$ 261    | \$ 1,058  | \$ 2,210  |
| Acquisitions:  |           |           |           |
| Fair value of noncash assets acquired                | \$ ---    | \$ 41,576 | \$ ---    |
| Fair value of liabilities assumed                    | \$ ---    | (42,773)  | ---       |

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

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**BAR HARBOR BANKSHARES AND SUBSIDIARIES**

**(All dollar amounts expressed in thousands, except share and per share data)**

**Note 1: Summary of Significant Accounting Policies**

The accounting and reporting policies of Bar Harbor Bankshares (the Company) and its wholly-owned operating subsidiary, Bar Harbor Bank & Trust (the Bank), conform to U.S. generally accepted accounting principles (GAAP) and to general practice within the banking industry.

The Company's principal business activity is retail and commercial banking and, to a lesser extent, financial services including trust, financial planning, investment management and third-party brokerage services. The Company's business is conducted through the Company's fifteen banking offices located throughout downeast, midcoast and central Maine.

The Company is a bank holding company registered under the Bank Holding Company Act of 1956, as amended, and is subject to supervision, regulation and examination by the Board of Governors of the Federal Reserve System. The Company is also a Maine Financial Institution Holding Company for the purposes of the laws of the state of Maine, and as such is subject to the jurisdiction of the Superintendent of the Maine Bureau of Financial Institutions. The Bank is subject to the supervision, regulation, and examination of the FDIC and the Maine Bureau of Financial Institutions.

**Financial Statement Presentation:** The accompanying consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles.

The consolidated financial statements include the accounts of Bar Harbor Bankshares and its wholly-owned subsidiary, Bar Harbor Bank & Trust. All significant inter-company balances and transactions have been eliminated in consolidation. Whenever necessary, amounts in the prior years' financial statements are reclassified to conform to current presentation. Assets held in a fiduciary capacity are not assets of the Company and, accordingly, are not included in the consolidated balance sheets.

In preparing financial statements in conformity with U.S. generally accepted accounting principles, management is required to make estimates and assumptions that affect the reported amount of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to change in the near term relate to the determination of the allowance for loan losses, other-than temporary impairment on securities, income tax estimates, reviews of goodwill for impairment, and accounting for postretirement plans.

***Subsequent Events:*** The Company has evaluated events and transactions subsequent to December 31, 2013 through report issuance, for potential recognition or disclosure as required by GAAP.

***Cash and Cash Equivalents:*** For purposes of reporting cash flows, cash and cash equivalents include cash and due from banks, federal funds sold and other short-term investments with maturities less than 90 days.

In the normal course of business, the Bank has funds on deposit at other financial institutions in amounts in excess of the \$250 that is insured by the Federal Deposit Insurance Corporation.

**Investment Securities:** All securities held at December 31, 2013 and 2012 were classified as available-for-sale ( AFS ). Available-for-sale securities consist of mortgage-backed securities and municipal debt securities, and are carried at estimated fair value. Changes in estimated fair value of AFS securities, net of applicable income taxes, are reported in accumulated other comprehensive income (loss) as a separate component of shareholders' equity. The Bank does not have a securities trading portfolio or securities held-to-maturity.

Premiums and discounts on securities are amortized and accreted over the term of the securities using the interest method. Gains and losses on the sale of securities are recognized at the trade date using the specific-identification method and are shown separately in the consolidated statements of income.

**Other-Than-Temporary Impairments on Investment Securities:** One of the significant estimates relating to securities is the evaluation of other-than-temporary impairment ( OTTI ). If a decline in the fair value of a debt security is judged to be other-than-temporary, and management does not intend to sell the security and believes it is more-likely-than-not the Company will not be required to sell the security prior to recovery of cost or amortized cost, the portion of the total impairment attributable to the credit loss is recognized in earnings, and the remaining difference between the security's amortized cost basis and its fair value is included in other comprehensive income.

For impaired available-for-sale debt securities that management intends to sell, or where management believes it is more-likely-than-not that the Company will be required to sell, an other-than-temporary impairment charge is recognized in earnings equal to the difference between fair value and cost or amortized cost basis of the security. The fair value of the other-than-temporarily impaired security becomes its new cost basis.

The evaluation of securities for impairments is a quantitative and qualitative process, which is subject to risks and uncertainties and is intended to determine whether declines in the fair value of securities should be recognized in current period earnings. The risks and uncertainties include changes in general economic conditions, the issuer's financial condition and/or future prospects, the effects of changes in interest rates or credit spreads and the expected recovery period of unrealized losses. The Company has a security monitoring process that identifies securities that, due to certain characteristics, as described below, are subjected to an enhanced analysis on a quarterly basis.

Securities that are in an unrealized loss position are reviewed at least quarterly to determine if they are other-than-temporarily impaired based on certain quantitative and qualitative factors and measures. The primary factors considered in evaluating whether a decline in value of securities is other-than-temporary include: (a) the cause of the impairment; (b) the financial condition, credit rating and future prospects of the issuer; (c) whether the debtor is current on contractually obligated interest and principal payments; (d) the volatility of the securities' fair value; (e) performance indicators of the underlying assets in the security including default rates, delinquency rates, percentage of non-performing assets, loan to collateral value ratios, third party guarantees, current levels of subordination, vintage, and geographic concentration and; (f) any other information and observable data considered relevant in determining whether other-than-temporary impairment has occurred, including the expectation of the receipt of all principal and interest due.

For securitized financial assets with contractual cash flows, such as private-label mortgage-backed securities, the Company periodically updates its best estimate of cash flows over the life of the security. The Company's best estimate of cash flows is based upon assumptions consistent with the current economic recession, similar to those the Company believes market participants would use. If the fair value of a securitized financial asset is less than its cost or amortized cost and there has been an adverse



change in timing or amount of anticipated future cash flows since the last revised estimate, to the extent that the Company does not expect to receive the entire amount of future contractual principal and interest, an other-than-temporary impairment charge is recognized in earnings representing the estimated credit loss if management does not intend to sell the security and believes it is more-likely-than-not the Company will not be required to sell the security prior to recovery of cost or amortized cost. Estimating future cash flows is a quantitative and qualitative process that incorporates information received from third party sources along with certain assumptions and judgments regarding the future performance of the underlying collateral. In addition, projections of expected future cash flows may change based upon new information regarding the performance of the underlying collateral.

**Federal Home Loan Bank Stock:** The Bank is a member of the Federal Home Loan Bank of Boston ( FHLB ). The Bank uses the FHLB for most of its wholesale funding needs. As a requirement of membership in the FHLB, the Bank must own a minimum required amount of FHLB stock, calculated periodically based primarily on its level of borrowings from the FHLB. FHLB stock is a non-marketable equity security and therefore is reported at cost, which generally equals par value. Shares held in excess of the minimum required amount are generally redeemable at par value.

The Company periodically evaluates its investment in FHLB stock for impairment based on, among other things, the capital adequacy of the FHLB and its overall financial condition. Based on the capital adequacy, liquidity position and sustained profitability of the FHLB, management believes there is no impairment related to the carrying amount of the Bank's FHLB stock as of December 31, 2013.

**Loans:** Loans are carried at the principal amounts outstanding adjusted by partial charge-offs and net deferred loan origination costs or fees.

Interest on loans is accrued and credited to income based on the principal amount of loans outstanding. Residential real estate and home equity loans are generally placed on non-accrual status when reaching 90 days past due, or in process of foreclosure, or sooner if judged appropriate by management. Consumer loans are generally placed on non-accrual when reaching 90 days or more past due, or sooner if judged appropriate by management. Secured consumer loans are written down to realizable value and unsecured consumer loans are charged-off upon reaching 120 days past due. Commercial real estate loans and commercial business loans that are 90 days or more past due are generally placed on non-accrual status, unless secured by sufficient cash or other assets immediately convertible to cash, and the loan is in the process of collection. Commercial real estate and commercial business loans may be placed on non-accrual status prior to the 90 days delinquency date if considered appropriate by management. When a loan has been placed on non-accrual status, previously accrued and uncollected interest is reversed against interest on loans. A loan can be returned to accrual status when collectibility of principal is reasonably assured and the loan has performed for a period of time, generally six months.

Commercial real estate and commercial business loans are considered impaired when it becomes probable the Bank will not be able to collect all amounts due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status and collateral value. In considering loans for evaluation of impairment, management generally excludes smaller balance, homogeneous loans: residential

mortgage loans, home equity loans, and all consumer loans, unless such loans were restructured in a troubled debt restructuring. These loans are collectively evaluated for risk of loss.

Loan origination and commitment fees and direct loan origination costs are deferred, and the net amount is amortized as an adjustment of the related loans' yield, using the level yield method over the estimated lives of the related loans.

Loans acquired through the completion of a transfer, including loans acquired in a business combination, that have evidence of deterioration of credit quality since origination and for which it is probable, at acquisition, that the Corporation will be unable to collect all contractually required payment receivable are initially recorded at fair value (as determined by the present value of expected future cash flows) with no valuation allowance. The difference between the undiscounted cash flows expected at acquisition and the investment in the loan, or the accretable yield, is recognized as interest income on a level-yield method over the life of the loan. Contractually required payments for interest and principal that exceed the undiscounted cash flows expected at acquisition, or the nonaccretable difference, are not recognized as a yield adjustment or as a loss accrual or a valuation allowance. Increases in expected cash flows subsequent to the initial investment are recognized prospectively through adjustment of the yield on the loan over its remaining life. Decreases in expected cash flows are recognized as impairment. Valuation allowances on these impaired loans reflect only losses incurred after the acquisition (meaning the present value of all cash flows expected at acquisition that ultimately are not to be received).

**Allowance for Loan Losses:** The allowance for loan losses (the allowance) is a significant accounting estimate used in the preparation of the Company's consolidated financial statements. The allowance is available to absorb losses inherent in the current loan portfolio and is maintained at a level that, in management's judgment, is appropriate for the amount of risk inherent in the loan portfolio, given past and present conditions. The allowance is increased by provisions charged to operating expense and by recoveries on loans previously charged off, and is decreased by loans charged off as uncollectible.

Arriving at an appropriate level of allowance for loan losses involves a high degree of judgment. The determination of the adequacy of the allowance and provisioning for estimated losses is evaluated regularly based on review of loans, with particular emphasis on non-performing and other loans that management believes warrant special consideration. The ongoing evaluation process includes a formal analysis, which considers among other factors: the character and size of the loan portfolio, business and economic conditions, real estate market conditions, collateral values, changes in product offerings or loan terms, changes in underwriting and/or collection policies, loan growth, previous charge-off experience, delinquency trends, non-performing loan trends, the performance of individual loans in relation to contract terms, and estimated fair values of collateral.

The allowance for loan losses consists of allowances established for specific loans including impaired loans; allowances for pools of loans based on historical charge-offs by loan types; and supplemental allowances that adjust historical loss experience to reflect current economic conditions, industry specific risks, and other observable data.

While management uses available information to recognize losses on loans, changing economic conditions and the economic prospects of the borrowers may necessitate future additions or reductions to the allowance. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance, which also may necessitate future additions or reductions to the allowance, based on information available to them at the time of their examination.

Refer to Note 4 of these consolidated financial statements, *Loans and Allowance for Loan Losses*, for further information on the allowance for loan losses, including the Company's loan loss estimation methodology.

***Premises and Equipment:*** Premises and equipment and related improvements are stated at cost less accumulated depreciation. Depreciation is computed on the straight-line method over the lesser of the lease term or estimated useful lives of related assets; generally 25 to 40 years for premises and three to seven years for furniture and equipment.

***Goodwill and Identifiable Intangible Assets:*** In connection with acquisitions, the Company generally records as assets on its consolidated financial statements both goodwill and identifiable intangible assets, such as core deposit intangibles.

The Company evaluates whether the carrying value of its goodwill has become impaired, in which case the value is reduced through a charge to its earnings. Goodwill is evaluated for impairment at least annually, or upon a triggering event using certain fair value techniques. Goodwill impairment testing is performed at the segment (or reporting unit) level. Goodwill is assigned to reporting units at the date the goodwill is initially recorded. Once goodwill has been assigned to the reporting units, it no longer retains its association with a particular acquisition, and all of the activities within a reporting unit, whether acquired or organically grown, are available to support the value of the goodwill.

Goodwill represents the excess of the purchase price over the fair value of net assets acquired in accordance with the purchase method of accounting for business combinations. Goodwill is not amortized but, instead, is subject to impairment tests on at least an annual basis or more frequently if an event occurs or circumstances change that reduce the fair value of a reporting unit below its carrying amount. The Company completes its annual goodwill impairment test as of December 31 of each year. The impairment testing process is conducted by assigning assets and goodwill to each reporting unit. Currently, the Company's goodwill is evaluated at the entity level as there is only one reporting unit. The Company first assesses certain qualitative factors to determine if it is more likely than not that the fair value of the reporting unit is less than its carrying value. If it is more likely than not that the fair value of the reporting unit is less than the carrying value, then the fair value of each reporting unit is compared to the recorded book value (step one). If the fair value of the reporting unit exceeds its carrying value, goodwill is not considered impaired and (step two) is not considered necessary. If the carrying value of a reporting unit exceeds its fair value, the impairment test continues (step two) by comparing the carrying value of the reporting unit's goodwill to the implied fair value of goodwill. The implied fair value is computed by adjusting all assets and liabilities of the reporting unit to current fair value with the offset adjustment to goodwill. The adjusted goodwill balance is the implied fair value of the goodwill. An impairment charge is recognized if the carrying fair value of goodwill exceeds the implied fair value of goodwill. At December 31, 2013, there was no indication of impairment that led the Company to believe it needed to perform a two-step test.

Identifiable intangible assets, included in other assets on the consolidated balance sheet, consist of core deposit intangibles amortized over their estimated useful lives on a straight-line method, which approximates the economic benefits to the Company. These assets are reviewed for impairment at least annually, or whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. The determination of which intangible assets have finite lives is subjective, as is the determination of the amortization period for such intangible assets.

Any changes in the estimates used by the Company to determine the carrying value of its goodwill and identifiable intangible assets, or which otherwise adversely affect their value or estimated lives, would adversely affect the Company's consolidated results of operations.

***Bank-Owned Life Insurance:*** Bank-owned life insurance ( BOLI ) represents life insurance on the lives of certain retired employees who had provided positive consent allowing the Bank to be the beneficiary of such policies. Increases in the cash value of the policies, as well as insurance proceeds received in excess of the cash value, are recorded in other non-interest income, and are not subject to income taxes. The cash surrender value is included in other assets on the Company's consolidated balance sheet. The Company reviews the financial strength of the insurance carrier prior to the purchase of BOLI and annually thereafter.

***Mortgage Servicing Rights:*** Mortgage servicing rights are recognized as separate assets when purchased or when retained in a sale of financial assets. Capitalized servicing rights are reported in other assets and are amortized into non-interest 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. 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 to the extent that fair value is less than the carrying value of the rights.

***Other Real Estate Owned:*** Real estate acquired in satisfaction of a loan is reported in other assets. Properties acquired by foreclosure or deed in lieu of foreclosure are transferred to other real estate owned and recorded at the lower of cost or fair market value less estimated costs to sell based on appraised value at the date actually or constructively received. Loan losses arising from the acquisition of such property are charged against the allowance for loan losses. Subsequent reductions in market value below the carrying value are charged to other operating expenses.

***Derivative Financial Instruments:*** The Company recognizes all derivative instruments on the consolidated balance sheet at fair value. On the date the derivative instrument is entered into, the Company designates whether the derivative is part of a hedging relationship (i.e., cash flow or fair value hedge). The Company formally documents relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking hedge transactions. The Company also assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives used in hedging transactions are highly effective in offsetting the changes in cash flows or fair values of hedged items.

Changes in fair value of derivative instruments that are highly effective and qualify as a cash flow hedge are recorded in other comprehensive income or loss. Any ineffective portion is recorded in earnings. For fair value hedges that are highly effective, the gain or loss on the derivative and the loss or gain on the hedged item attributable to the hedged risk are both recognized in earnings, with the differences (if any) representing hedge ineffectiveness. The Company discontinues hedge accounting when it is determined that the derivative is no longer highly effective in offsetting changes of the hedged risk on the hedged item, or management determines that the designation of the derivative as a hedging instrument is no longer appropriate.

***Off-Balance Sheet Financial Instruments:*** In the ordinary course of business the Company has entered into off-balance sheet financial instruments consisting of commitments to extend credit, and standby letters of credit. Such financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received.

***Stock Based Compensation:*** The Company has stock option plans, which are described more fully in Note 12. The Company expenses the grant date fair value of options granted. The expense is recognized over the vesting periods of the grants.

***Accounting for Retirement Benefit Plans:*** The Company has non-qualified supplemental executive retirement agreements with certain retired officers. The agreements provide supplemental retirement benefits payable in installments over a period of years upon retirement or death. The Company recognized the net present value of payments associated with the agreements over the service periods of the participating officers. Interest costs continue to be recognized on the benefit obligations. The Company also has a supplemental executive retirement agreement with a certain current executive officer. This



agreement provides a stream of future payments in accordance with individually defined vesting schedules upon retirement, termination, or in the event that the participating executive leaves the

Company following a change of control event. The Company recognizes the net present value of payments associated with these agreements over the service periods of the participating executive officers. Upon retirement, interest costs will continue to be recognized on the benefit obligation.

The Company recognizes the over-funded or under-funded status of postretirement benefit plans as an asset or liability on the balance sheet and recognizes changes in that funded status through other comprehensive income. Gains and losses, prior service costs and credits, and any remaining transition amounts that have not yet been recognized through net periodic benefit costs are recognized in accumulated other comprehensive income (loss), net of tax effects, until they are amortized as a component of net periodic cost. The measurement date, which is the date at which the benefit obligation and plan assets are measured, is the Company's fiscal year end.

**Income Taxes:** The Company uses the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. If current available information indicates that it is more likely than not that deferred tax assets will not be realized, a valuation allowance is established. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

The Company performs an analysis of its tax positions and has not identified any uncertain tax positions for which tax benefits should not be recognized as of December 31, 2013. The Company's policy is to report interest and penalties, if any, related to unrecognized tax benefits in income tax expense in the consolidated statements of income.

The Company's income tax returns are currently open to audit under the statute of limitations by the Internal Revenue Service for the years ended December 31, 2010 through 2012.

**Earnings Per Share:** Basic earnings per share excludes dilution and is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflect the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company, such as the Company's dilutive stock options.

**Segment Reporting:** An operating segment is defined as a component of a business for which separate financial information is available that is evaluated regularly by the chief operating decision-maker in deciding how to allocate resources and evaluate performance. The Company has determined that its operations are solely in the community

banking industry and include traditional community banking services, including lending activities, acceptance of demand, savings and time deposits, business services, investment management, trust and third-party brokerage services. These products and services have similar distribution methods, types of customers and regulatory responsibilities. Accordingly, disaggregated segment information is not presented in the notes to the consolidated financial statements.

**Note 2: Business Combinations**

On August 10, 2012, Bar Harbor Bank & Trust (the Bank), a wholly-owned first tier operating subsidiary of Bar Harbor Bankshares, completed its acquisition of the operations of the Border Trust Company (Border Trust), a state chartered bank headquartered in Augusta, Maine, by acquiring certain assets and assuming certain liabilities, including all deposits for a net purchase price of \$133. This transaction represented a strategic extension of the Company's franchise with three branch locations located in Kennebec and Sagadahoc counties.

The Company has determined that the acquisition of the net assets of Border Trust constituted a business combination as defined by the FASB ASC Topic 805, *Business Combinations*. Accordingly, the assets acquired and liabilities assumed were recorded at their fair values. Fair values were determined based on the requirements of FASB ASC Topic 820, *Fair Value Measurements*. In many cases, the determination of these fair values required management to make estimates about discount rates, future expected cash flows, market conditions and other future events that are highly subjective in nature and subject to change. These fair value estimates are subject to change for up to one year after the closing date of the transaction as additional information relative to closing date fair values becomes available. In addition, the tax treatment is complex and subject to interpretations that may result in future adjustments of deferred taxes as of the acquisition date.

The results of Border Trust's operations are included in the Consolidated Statements of Income from the date of acquisition. In connection with this transaction, the consideration paid, the assets acquired, and the liabilities assumed were recorded at fair value on the date of acquisition, as summarized in the following table.

|   |                |
|---|----------------|
| <b>Fair value of total consideration paid:</b>                      |                |
| Cash consideration paid at closing to Border Trust                  | \$ 133         |
| <b>Fair value of identifiable assets acquired:</b>                  |                |
| Cash and cash equivalents   | \$ 1,330       |
| Securities  | 3,537          |
| Federal Home Loan Bank Common stock                                 | 770            |
| Loans   | 33,606         |
| Premises and equipment  | 563            |
| Core deposit intangible   | 783            |
| Other assets  | 540            |
| Total identifiable assets acquired                                  | 41,129         |
| <b>Fair value of liabilities assumed:</b>                           |                |
| Deposits  | 38,520         |
| Borrowings  | 3,776          |
| Other liabilities   | 477            |
| Total liabilities assumed   | 42,773         |
| <b>Fair value of net identifiable assets (liabilities) acquired</b> | <b>(1,644)</b> |

|  |          |
|--|----------|
| <b>Goodwill resulting from transaction</b> | \$ 1,777 |
|--|----------|

Goodwill of \$1,777 was recorded after adjusting for the fair value of net identifiable assets acquired. The goodwill from the acquisition represents the inherent long-term value anticipated from the synergies and business opportunities expected to be achieved as a result of the transaction. The core deposit intangible asset is being amortized over its estimated life, currently expected to be eight and one-half years.

**Note 3: Securities Available For Sale**

A summary of the amortized cost and market values of securities available for sale follows:

| <b>December 31, 2013</b>            |                  | <b>Gross</b>      | <b>Gross</b>      |                   |
|-------------------------------------|------------------|-------------------|-------------------|-------------------|
|                                     | <b>Amortized</b> | <b>Unrealized</b> | <b>Unrealized</b> | <b>Estimated</b>  |
| <b>Available for Sale:</b>          | <b>Cost</b>      | <b>Gains</b>      | <b>Losses</b>     | <b>Fair Value</b> |
| Mortgage-backed securities:         |                  |                   |                   |                   |
| US Government-sponsored enterprises | \$277,838        | \$ 4,386          | \$ 8,592          | \$273,632         |
| US Government agency                | 83,153           | 833               | 2,457             | 81,529            |
| Private label                       | 5,423            | 825               | 78                | 6,170             |
| Obligations of states               |                  |                   |                   |                   |
| and political subdivisions thereof  | 95,221           | 1,121             | 7,503             | 88,839            |
| Total                               | \$461,635        | \$ 7,165          | \$18,630          | \$450,170         |

| <b>December 31, 2012</b>            |                  | <b>Gross</b>      | <b>Gross</b>      |                   |
|-------------------------------------|------------------|-------------------|-------------------|-------------------|
|                                     | <b>Amortized</b> | <b>Unrealized</b> | <b>Unrealized</b> | <b>Estimated</b>  |
| <b>Available for Sale:</b>          | <b>Cost</b>      | <b>Gains</b>      | <b>Losses</b>     | <b>Fair Value</b> |
| Mortgage-backed securities:         |                  |                   |                   |                   |
| US Government-sponsored enterprises | \$238,974        | \$ 7,913          | \$ 1,064          | \$245,823         |
| US Government agency                | 82,397           | 2,080             | 216               | 84,261            |
| Private label                       | 8,063            | 571               | 521               | 8,113             |
| Obligations of states               |                  |                   |                   |                   |
| and political subdivisions thereof  | 76,335           | 4,040             | 532               | 79,843            |
| Total                               | \$405,769        | \$14,604          | \$ 2,333          | \$418,040         |

**Securities Impairment:** As a part of the Company's ongoing security monitoring process, the Company identifies securities in an unrealized loss position that could potentially be other-than-temporarily impaired.

For the year ended December 31, 2013, the Company recorded total OTTI losses of \$359 (before taxes), related to three, available for sale, 1-4 family, private-label MBS, all of which the Company had previously determined was other-than-temporarily impaired. Of the \$359 in total OTTI losses, \$249 (before taxes) represented estimated credit losses on the collateral underlying the securities, while \$110 (before taxes) represented unrealized losses for the same securities resulting from factors other than credit. The \$249 in estimated credit losses were recorded in earnings (before taxes) with the \$110 non-credit portion of the unrealized losses recorded within accumulated other

comprehensive income (net of taxes). The additional credit losses principally reflected an increase in the future loss severity and constant default rate estimates resulting from still-recovering real estate markets, extended foreclosure and collateral liquidation timelines, and still-depressed economic conditions that affected the expected performance of the mortgage loans underlying these securities.

For the year ended December 31, 2012, the Company recorded total OTTI losses of \$1,170 (before taxes), related to fourteen, available for sale, 1-4 family, private-label MBS, all but two of which the Company had previously determined was other-than-temporarily impaired. Of the \$1,170 in total OTTI losses, \$853 (before taxes) represented estimated credit losses on the collateral underlying the securities, while \$317 (before taxes) represented unrealized losses for the same securities resulting from factors other than credit. The \$853 in estimated credit losses were recorded in earnings (before taxes) with the \$317 non-

credit portion of the unrealized losses recorded within accumulated other comprehensive income (net of taxes). The additional credit losses principally reflected an increase in the future loss severity and constant default rate estimates resulting from depressed real estate markets, extended foreclosure and collateral liquidation timelines, and depressed economic conditions that affected the expected performance of the mortgage loans underlying these securities.

The OTTI losses recognized in earnings represented management's best estimate of credit losses inherent in the securities based on discounted, bond-specific future cash flow projections using assumptions about cash flows associated with the pools of loans underlying each security. In estimating those cash flows the Company considered loan level credit characteristics, current delinquency and non-performing loan rates, current levels of subordination and credit support, recent default rates and future constant default rate estimates, loan to collateral value ratios, recent collateral loss severities and future collateral loss severity estimates, recent prepayment rates and future prepayment rate assumptions, and other estimates of future collateral performance.

Despite elevated levels of delinquencies, defaults and losses in the underlying residential mortgage loan collateral, given credit enhancements resulting from the structures of the individual securities, the Company currently expects that as of December 31, 2013 it will recover the amortized cost basis of its private-label mortgage-backed securities and has therefore concluded that such securities were not other-than-temporarily impaired as of that date. Nevertheless, given future market conditions, it is possible that adverse changes in repayment performance and fair value could occur in future periods that could impact the Company's current best estimates.

The following table displays the beginning balance of OTTI related to historical credit losses on debt securities held by the Company at the beginning of the current reporting period as well as changes in estimated credit losses recognized in pre-tax earnings for the three years ended December 31, 2013.

|  | 2013           | 2012           | 2011           |
|--|----------------|----------------|----------------|
| <b>Estimated credit losses as of prior year-end,</b> | \$5,131        | \$4,697        | \$3,373        |
| Additions for credit losses for securities on which  |                |                |                |
| OTTI has been previously recognized                  | 249            | 682            | 1,757          |
| Additions for credit losses for securities on which  |                |                |                |
| OTTI has not been previously recognized              | ---            | 171            | 462            |
| Reductions for securities paid off during the period | 691            | 419            | 895            |
| <b>Estimated credit losses as of December 31,</b>    | <b>\$4,689</b> | <b>\$5,131</b> | <b>\$4,697</b> |

Upon initial impairment of a security, total OTTI losses represent the excess of the amortized cost over the fair value. For subsequent impairments of the same security, total OTTI losses represent additional credit losses and or declines in fair value subsequent to the previously recorded OTTI losses, if applicable. Unrealized OTTI losses recognized in accumulated other comprehensive income (OCI) represent the non-credit component of OTTI losses on debt securities. Net impairment losses recognized in earnings represent the credit component of OTTI losses on debt

securities.

As of December 31, 2013, the Company held fourteen private-label MBS (debt securities) with a total amortized cost (i.e. carrying value) of \$2,681 where OTTI losses have been historically recognized in pre-tax earnings (dating back to the fourth quarter of 2008). For twelve of these securities, the Company previously recognized credit losses in excess of the unrealized losses in accumulated OCI, creating an unrealized gain of \$519, net of tax, as included in accumulated OCI as of December 31, 2013. For the remaining two securities, the total OTTI losses included in accumulated OCI amounted to \$30 net of tax,



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as of December 31, 2013. As of December 31, 2013, the total net unrealized gains included in accumulated OCI for securities held where OTTI has been historically recognized in pre-tax earnings amounted to \$488, net of tax, compared with net unrealized gains of \$144, net of tax, at December 31, 2012.

As of December 31, 2013, based on a review of the remaining securities in the securities portfolio, the Company concluded that it expects to recover its amortized cost basis for such securities. This conclusion was based on the issuers' continued satisfaction of the securities obligations in accordance with their contractual terms and the expectation that they will continue to do so through the maturity of the security, the expectation that the Company will receive the entire amount of future contractual cash flows, as well as the evaluation of the fundamentals of the issuers' financial condition and other objective evidence. Accordingly, the Company concluded that the declines in the values of those securities were temporary and that any additional other-than-temporary impairment charges were not appropriate at December 31, 2013. As of that date, the Company did not intend to sell nor anticipated that it would more-likely-than-not that it would be required to sell any of its impaired securities, that is, where fair value is less than the cost basis of the security.

The following tables summarize the fair value of securities with continuous unrealized losses for less than 12 months and those that have been in a continuous unrealized loss position for 12 months or longer as of December 31, 2013 and 2012. All securities referenced are debt securities. At December 31, 2013 and 2012, the Company did not hold any common stock or other equity securities in its securities portfolio.

| Description of Securities:              | Less than 12 months |                       |                   | 12 months or longer |                       |                   | Total      |                       |                   |
|---|---------------------|-----------------------|-------------------|---------------------|-----------------------|-------------------|------------|-----------------------|-------------------|
|   | Estimated           |                       |                   | Estimated           |                       |                   | Estimated  |                       |                   |
|   | Fair Value          | Number of Investments | Unrealized Losses | Fair Value          | Number of Investments | Unrealized Losses | Fair Value | Number of Investments | Unrealized Losses |
| December 31, 2013                       |                     |                       |                   |                     |                       |                   |            |                       |                   |
| Mortgage-backed securities:             |                     |                       |                   |                     |                       |                   |            |                       |                   |
| US Government-                          |                     |                       |                   |                     |                       |                   |            |                       |                   |
| sponsored enterprises                   | \$111,169           | 140                   | \$ 4,801          | \$40,563            | 40                    | \$3,791           | \$151,732  | 180                   | \$ 8,592          |
| US Government agency                    | 36,356              | 47                    | 1,982             | 9,156               | 12                    | 475               | 45,512     | 59                    | 2,457             |
| Private label Obligations of states and | 826                 | 12                    | 61                | 449                 | 7                     | 17                | 1,275      | 19                    | 78                |
| political subdivisions thereof          | 61,174              | 135                   | 5,601             | 8,464               | 30                    | 1,902             | 69,638     | 165                   | 7,503             |

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|       |           |     |          |          |    |         |           |     |          |
|-------|-----------|-----|----------|----------|----|---------|-----------|-----|----------|
| Total | \$209,525 | 334 | \$12,445 | \$58,632 | 89 | \$6,185 | \$268,157 | 423 | \$18,630 |
|-------|-----------|-----|----------|----------|----|---------|-----------|-----|----------|

| Description of Securities:   | Less than 12 months |                       |                   | 12 months or longer |                       |                   | Total      |                       |                   |
|--|---------------------|-----------------------|-------------------|---------------------|-----------------------|-------------------|------------|-----------------------|-------------------|
|  | Estimated           |                       |                   | Estimated           |                       |                   | Estimated  |                       |                   |
|  | Fair Value          | Number of Investments | Unrealized Losses | Fair Value          | Number of Investments | Unrealized Losses | Fair Value | Number of Investments | Unrealized Losses |
| Mortgage-backed securities:  |                     |                       |                   |                     |                       |                   |            |                       |                   |
| US Government-sponsored enterprises                                    | \$ 56,008           | 55                    | \$ 1,064          | \$ ---              | ---                   | \$ ---            | \$ 56,008  | 55                    | \$ 1,064          |
| US Government agency   | 15,281              | 18                    | 216               | 56                  | 2                     | ---               | 15,337     | 20                    | 216               |
| Private label Obligations of states and political subdivisions thereof | 783                 | 6                     | 48                | 2,196               | 14                    | 473               | 2,979      | 20                    | 521               |
| Total  | \$ 82,548           | 106                   | \$ 1,589          | \$ 4,813            | 28                    | \$ 744            | \$ 87,361  | 134                   | \$ 2,333          |

For securities with unrealized losses, the following information was considered in determining that the impairments were not other-than-temporary:

**Mortgage-backed securities issued by U.S. Government-sponsored enterprises:** As of December 31, 2013, the total unrealized losses on these securities amounted to \$8,592, compared with \$1,064 at December 31, 2012. All of these securities were credit rated AA+ by the major credit rating agencies. Company management believes these securities have minimal credit risk, as these

enterprises play a vital role in the nation's financial markets. Management's analysis indicates that the unrealized losses at December 31, 2013 were attributed to changes in current market yields and pricing spreads for similar securities since the date the underlying securities were purchased, and does not consider these securities to be other-than-temporarily impaired at December 31, 2013.

***Mortgage-backed securities issued by U.S. Government agencies:*** As of December 31, 2013, the total unrealized losses on these securities amounted to \$2,457, compared with \$216 at December 31, 2012. All of these securities were credit rated AA+ by the major credit rating agencies. Management's analysis indicates that these securities bear little or no credit risk because they are backed by the full faith and credit of the United States. The Company attributes the unrealized losses at December 31, 2013 to changes in current market yields and pricing spreads for similar securities since the date the underlying securities were purchased, and does not consider these securities to be other-than-temporarily impaired at December 31, 2013.

***Private-label mortgage-backed securities:*** As of December 31, 2013, the total unrealized losses on the Bank's private-label mortgage-backed securities amounted to \$78, compared with \$521 at December 31, 2012. The Company attributes the unrealized losses at December 31, 2013 to the current illiquid market for non-agency mortgage-backed securities, a still-recovering housing market, risk-related market pricing discounts for non-agency mortgage-backed securities and credit rating downgrades on certain private-label MBS owned by the Company. Based upon the foregoing considerations, and the expectation that the Company will receive all of the future contractual cash flows related to the amortized cost on these securities, the Company does not consider there to be any additional other-than-temporary impairment with respect to these securities at December 31, 2013.

***Obligations of states of the U.S. and political subdivisions thereof:*** As of December 31, 2013, the total unrealized losses on the Bank's municipal securities amounted to \$7,503, compared with \$532 at December 31, 2012. The Bank's municipal securities primarily consist of general obligation bonds and to a lesser extent, revenue bonds. General obligation bonds carry less risk, as they are supported by the full faith, credit and taxing authority of the issuing government and in the cases of school districts, are additionally supported by state aid. Revenue bonds are generally backed by municipal revenue streams generated through user fees or lease payments associated with specific municipal projects that have been financed.

Municipal bonds are frequently supported with insurance, which guarantees that in the event the issuer experiences financial problems, the insurer will step in and assume payment of both principal and interest. Historically, insurance support has strengthened an issuer's underlying credit rating to AAA or AA status. Starting in 2008 and continuing through 2013, many of the insurance companies providing municipal bond insurance experienced financial difficulties and, accordingly, were downgraded by at least one of the major credit rating agencies. Consequently, since 2008 a portion of the Bank's municipal bond portfolio was downgraded by at least one of the major credit rating agencies. Notwithstanding the credit rating downgrades, at December 31, 2013, the Bank's municipal bond portfolio did not contain any below investment grade securities as reported by major credit rating agencies. In addition, at December 31, 2013 all municipal bond issuers were current on contractually obligated interest and principal payments.

The Company attributes the unrealized losses at December 31, 2013 to changes in credit ratings on certain securities and resulting changes in prevailing market yields and pricing spreads since the date the underlying securities were purchased. The Company also attributes the unrealized losses to ongoing media attention and market concerns about the prolonged recovery from the



national economic recession and the impact it might have on the future financial stability of municipalities throughout the country. Accordingly, the Company does not consider these municipal securities to be other-than-temporarily impaired at December 31, 2013.

At December 31, 2013, the Company had no intent to sell nor believed it is more-likely-than-not that it would be required to sell any of its impaired securities as identified and discussed immediately above, and therefore did not consider these securities to be other-than-temporarily impaired as of that date.

**Maturity Distribution:** The following table summarizes the maturity distribution of the amortized cost and estimated fair value of securities available for sale as of December 31, 2013.

| <b>Securities Available for Sale</b>   | <b>Amortized<br/>Cost</b> | <b>Estimated<br/>Fair Value</b> |
|--|---------------------------|---------------------------------|
| Due one year or less                   | \$ ---                    | \$ ---                          |
| Due after one year through five years  | 4,360                     | 4,450                           |
| Due after five years through ten years | 20,080                    | 20,625                          |
| Due after ten years                    | 437,195                   | 425,095                         |
| Total                                  | \$461,635                 | \$450,170                       |

Actual maturities may differ from the final contractual maturities depicted above because of securities call or prepayment provisions with or without call or prepayment penalties. The contractual maturity of mortgage-backed securities is not a reliable indicator of their expected life because borrowers have the right to prepay their obligations at any time. Monthly pay downs on mortgage-backed securities cause the average lives of the securities to be much different than their stated lives. Mortgage-backed securities are allocated among the maturity groupings based on their final maturity dates.

**Realized Securities Gains and Losses:**

The following table summarizes realized gains and losses and other than temporary impairment losses on securities available for sale for the years ended December 31, 2013, 2012 and 2011.

| <b>Proceeds from<br/>Sale of Securities</b> | <b>Realized<br/>Gains</b> | <b>Realized<br/>Losses</b> | <b>Other Than<br/>Temporary</b> | <b>Net</b> |
|---|---------------------------|----------------------------|---------------------------------|------------|
|---|---------------------------|----------------------------|---------------------------------|------------|

|             | <b>Available for Sale</b> |         |        | <b>Impairment Losses</b> |         |  |
|-------------|---------------------------|---------|--------|--------------------------|---------|--|
| <b>2013</b> | \$17,234                  | \$ 684  | (\$ 8) | \$ 249                   | \$ 427  |  |
| <b>2012</b> | \$39,304                  | \$1,963 | (\$25) | \$ 853                   | \$1,085 |  |
| <b>2011</b> | \$48,468                  | \$2,689 | \$ --- | \$2,219                  | \$ 470  |  |

**Note 4: Loans and Allowance for Loan Losses**

The Company's lending activities are principally conducted in downeast, midcoast and central Maine. The following table summarizes the composition of the loan portfolio as of December 31, 2013 and 2012:

**LOAN PORTFOLIO SUMMARY**

|  | <b>2013</b> | <b>2012</b> |
|--|-------------|-------------|
| Commercial real estate mortgages             | \$336,542   | \$324,493   |
| Commercial and industrial                    | 73,972      | 59,373      |
| Commercial construction and land development | 18,129      | 22,120      |
| Agricultural and other loans to farmers      | 26,929      | 24,922      |
| Total commercial loans                       | 455,572     | 430,908     |
| Residential real estate mortgages            | 317,115     | 297,103     |
| Home equity loans                            | 49,565      | 53,303      |
| Other consumer loans                         | 14,523      | 19,001      |
| Total consumer loans                         | 381,203     | 369,407     |
| Tax exempt loans                             | 16,355      | 15,244      |
| Net deferred loan costs and fees             | (273)       | (555)       |
| Total loans                                  | 852,857     | 815,004     |
| Allowance for loan losses                    | (8,475)     | (8,097)     |
| Total loans net of allowance for loan losses | \$844,382   | \$806,907   |

**Loan Origination/Risk Management:** The Company has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. The Company's Board of Directors reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing management and the board with frequent reports related to loan production, loan quality, concentrations of credit, loan delinquencies and non-performing loans and potential problem loans. The Company seeks to diversify the loan portfolio as a means of managing risk associated with fluctuations in economic conditions.

**Commercial Real Estate Mortgages:** The Bank's commercial real estate mortgage loans are collateralized by liens on real estate, typically have variable interest rates (or five year or less fixed rates) and amortize over a 15 to 20 year period. These loans are underwritten primarily as cash flow loans and secondarily as loans secured by real estate. Payments on loans secured by such properties are largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Accordingly, repayment of these loans may be subject to adverse economic conditions to a greater extent than other types of loans. The Company seeks to minimize these risks in a variety of ways, including giving careful consideration to the property's operating history,

future operating projections, current and projected occupancy, location and physical condition in connection with underwriting these loans. The underwriting analysis also includes credit verification, analysis of global cash flows, appraisals and a review of the financial condition of the borrower. Reflecting the Bank's business region, at December 31, 2013, approximately 32.6% of the commercial real estate mortgage portfolio was represented by loans to the lodging industry. The Bank underwrites lodging industry loans as operating businesses, lending primarily to seasonal establishments with stabilized cash flows.



**Commercial and Industrial Loans:** Commercial and industrial loans are underwritten after evaluating and understanding the borrower's ability to operate profitably, and prudently expand its business. Commercial and industrial loans are primarily made in the Bank's market areas and are underwritten on the basis of the borrower's ability to service the debt from income. As a general practice, the Bank takes as collateral a lien on any available real estate, equipment or other assets owned by the borrower and obtains a personal guaranty of the borrower or principal. Working capital loans are primarily collateralized by short-term assets whereas term loans are primarily collateralized by long-term assets. In general, commercial and industrial loans involve more credit risk than residential mortgage loans and commercial mortgage loans and, therefore, usually yield a higher return. The increased risk in commercial and industrial loans is principally due to the type of collateral securing these loans. The increased risk also derives from the expectation that commercial and industrial loans generally will be serviced principally from the operations of the business, and, if not successful, these loans are primarily secured by tangible, non-real estate collateral. As a result of these additional complexities, variables and risks, commercial and industrial loans generally require more thorough underwriting and servicing than other types of loans.

**Construction and Land Development Loans:** The Company makes loans to finance the construction of residential and, to a lesser extent, non-residential properties. Construction loans generally are collateralized by first liens on real estate. The Company conducts periodic inspections, either directly or through an agent, prior to approval of periodic draws on these loans. Underwriting guidelines similar to those described immediately above are also used in the Company's construction lending activities. Construction loans involve additional risks attributable to the fact that loan funds are advanced against a project under construction and the project is of uncertain value prior to its completion. Because of uncertainties inherent in estimating construction costs, the market value of the completed project and the effects of governmental regulation on real property, it can be difficult to accurately evaluate the total funds required to complete a project and the related loan to value ratio. As a result of these uncertainties, construction lending often involves the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project rather than the ability of a borrower or guarantor to repay the loan. In many cases the success of the project can also depend upon the financial support/strength of the sponsorship. If the Company is forced to foreclose on a project prior to completion, there is no assurance that the Company will be able to recover the entire unpaid portion of the loan. In addition, the Company may be required to fund additional amounts to complete a project and may have to hold the property for an indeterminate period of time. While the Company has underwriting procedures designed to identify what it believes to be acceptable levels of risks in construction lending, no assurance can be given that these procedures will prevent losses from the risks described above.

**Residential Real Estate Mortgages:** The Company originates first-lien, adjustable-rate and fixed-rate, one-to-four-family residential real estate loans for the construction, purchase or refinancing of a single family residential property. These loans are principally collateralized by owner-occupied properties, and are amortized over 10 to 30 years. From time to time the Company will sell longer-term, low rate, residential mortgage loans to the Federal Home Loan Mortgage Corporation ( FHLMC ) with servicing rights retained. This practice allows the Company to better manage interest rate risk and liquidity risk. In an effort to manage risk of loss and strengthen secondary market liquidity opportunities, management typically uses secondary market underwriting, appraisal, and servicing guidelines for all loans, including those held in its portfolio. Loans on one-to-four-family residential real estate are mostly originated in amounts of no more than 80% of appraised value or have private mortgage insurance. Mortgage title insurance and hazard insurance are required. Construction loans have a unique risk, because they are secured by an incomplete dwelling. This risk is reduced through more stringent underwriting standards, including regular inspections throughout the construction period.



**Home Equity Loans:** The Company originates home equity lines of credit and second mortgage loans (loans which are secured by a junior lien position on one-to-four-family residential real estate). These loans carry a higher risk than first mortgage residential loans as they are in a second position relating to collateral. Risk is reduced through underwriting criteria, which include credit verification, appraisals and evaluations, a review of the borrower's financial condition, and personal cash flows. A security interest, with title insurance when necessary, is taken in the underlying real estate.

**Troubled Debt Restructures:** A Troubled Debt Restructure ( TDR ) results from a modification to a loan to a borrower who is experiencing financial difficulty in which the Bank grants a concession to the debtor that it would not otherwise consider but for the debtor's financial difficulties. Financial difficulty arises when a debtor is bankrupt or contractually past due, or is likely to become so, based upon its ability to pay. A concession represents an accommodation not generally available to other customers, including a below-market interest rate, deferment of principal payments, extension of maturity dates, etc. Such accommodations extended to customers who are not experiencing financial difficulty do not result in TDR classification.

As of December 31, 2013, the Bank had six real estate secured, six commercial and industrial loans, and one other consumer loan, to eight relationships totaling \$1,454 that were classified as TDRs. At December 31, 2013, seven TDRs totaling \$416 were past due or classified as non-performing.

As of December 31, 2012, the Bank had four real estate secured and three commercial and industrial loans to four relationships totaling \$934 that were classified as TDRs. At December 31, 2012, three TDRs totaling \$114 were past due or classified as non-performing.

As of December 31, 2011, the Bank had four real estate secured loans totaling \$913 that were classified as TDRs, of which one in the amount of \$82 was past due and classified as non-performing.

Summary information pertaining to the TDRs granted during the years ended December 31, 2013 and 2012 follows:

|                                 | For the Twelve Months Ended |  |   | For the Twelve Months Ended |  |   |
|---------------------------------|-----------------------------|--|---|-----------------------------|--|---|
|                                 | December 31, 2013           |  |   | December 31, 2012           |  |   |
|                                 | Number of Loans             | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment | Number of Loans             | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
| Commercial and industrial loans | 3                           | \$173  | \$166   | 2                           | \$ 60  | \$ 60   |

|                                   |   |       |       |   |       |       |
|-----------------------------------|---|-------|-------|---|-------|-------|
| <b>Total commercial loans</b>     | 3 | 173   | 166   | 2 | 60    | 60    |
| Residential real estate mortgages | 1 | \$166 | \$164 | 2 | \$ 77 | \$ 77 |
| Home equity loans                 | 1 | 16    | 20    | 0 | ---   | ---   |
| Other consumer loans              | 1 | 14    | 13    | 0 | ---   | ---   |
| <b>Total consumer loans</b>       | 3 | 196   | 197   | 2 | 77    | 77    |
| <b>Total</b>                      | 6 | \$369 | \$363 | 4 | \$137 | \$137 |

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The following table shows the Company's post-modification balance of TDRs listed by type of modification for the twelve months ended December 31, 2013 and 2012:

|  | 2013         | 2012         |
|--|--------------|--------------|
| Extended maturity and adjusted interest rate | \$ 79        | \$ 23        |
| Temporary payment amount adjustment          | ---          | 54           |
| Court ordered concession                     | 284          | 60           |
| <b>Total</b>                                 | <b>\$363</b> | <b>\$137</b> |

**Past Due Loans:** Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. The following tables set forth information regarding past due loans at December 31, 2013 and December 31, 2012. Amounts shown exclude deferred loan origination fees and costs.

| December 31, 2013         | 30-59    | 60-89    | 90      | Total    | Current   | Total     | Non-    | >90 Days     |
|---------------------------|----------|----------|---------|----------|-----------|-----------|---------|--------------|
|                           | Days     | Days     | Days or |          |           |           |         |              |
|                           | Past Due | Past Due | Greater | Past Due |           | Loans     | Accrual | Past Due and |
|                           |          |          |         |          |           |           |         | Accruing     |
| Commercial real           |          |          |         |          |           |           |         |              |
| estate mortgages          | \$ 786   | \$ 361   | \$ 698  | \$ 1,845 | 334,697   | \$336,542 | \$2,046 | \$ ---       |
| Commercial and industrial | 29       | 20       | 456     | 505      | 73,467    | 73,972    | 793     | ---          |
| Commercial construction   |          |          |         |          |           |           |         |              |
| and land development      | ---      | ---      | 1,845   | 1,845    | 16,284    | 18,129    | 1,913   | ---          |
| Agricultural and other    |          |          |         |          |           |           |         |              |
| loans to farmers          | 22       | ---      | ---     | 22       | 26,907    | 26,929    | 56      | ---          |
| Residential real          |          |          |         |          |           |           |         |              |
| estate mortgages          | 2,170    | 1,864    | 1,649   | 5,683    | 311,432   | 317,115   | 3,227   | ---          |
| Home equity               | 67       | ---      | ---     | 67       | 49,498    | 49,565    | 745     | ---          |
| Other consumer loans      | 57       | 80       | 41      | 178      | 14,345    | 14,523    | 60      | ---          |
| Tax exempt                | ---      | ---      | ---     | ---      | 16,355    | 16,355    | ---     | ---          |
| Total                     | \$3,131  | \$2,325  | \$4,689 | \$10,145 | \$842,985 | \$853,130 | \$8,840 | \$ ---       |

| December 31, 2012 | 30-59    | 60-89    | 90      | Total    | Current | Total | Non-    | >90 Days     |
|-------------------|----------|----------|---------|----------|---------|-------|---------|--------------|
|                   | Days     | Days     | Days or |          |         |       |         |              |
|                   | Past Due | Past Due | Greater | Past Due |         | Loans | Accrual | Past Due and |
|                   |          |          |         |          |         |       |         | Accruing     |

## Commercial real

|                           |         |         |         |          |           |            |         |       |
|---------------------------|---------|---------|---------|----------|-----------|------------|---------|-------|
| estate mortgages          | \$ 228  | \$ 238  | \$1,041 | \$ 1,507 | \$322,986 | \$ 324,493 | \$1,888 | \$--- |
| Commercial and industrial | 22      | 61      | 990     | 1,073    | 58,300    | 59,373     | 818     | 216   |
| Commercial construction   |         |         |         |          |           |            |         |       |
| and land development      | ---     | ---     | 2,359   | 2,359    | 19,761    | 22,120     | 2,359   | ---   |
| Agricultural and other    |         |         |         |          |           |            |         |       |
| loans to farmers          | 203     | 12      | 490     | 705      | 24,217    | 24,922     | 664     | ---   |
| Residential real          |         |         |         |          |           |            |         |       |
| estate mortgages          | 2,452   | 769     | 1,951   | 5,172    | 291,931   | 297,103    | 3,017   | ---   |
| Home equity               | 219     | ---     | 274     | 493      | 52,810    | 53,303     | 814     | ---   |
| Other consumer loans      | 75      | 97      | 77      | 249      | 18,752    | 19,001     | 72      | 19    |
| Tax exempt                | ---     | ---     | ---     | ---      | 15,244    | 15,244     | ---     | ---   |
| Total                     | \$3,199 | \$1,177 | \$7,182 | \$11,558 | \$804,001 | \$815,559  | \$9,632 | \$235 |

At December 31, 2013, total other real estate owned amounted to \$1,625 compared with \$2,780 and \$2,699 at December 31, 2012 and 2011.

At December 31, 2013, the Company had no firm commitments to lend additional funds to borrowers with loans in non-accrual status.

**Impaired Loans:** Impaired loans are all commercial loans for which the Company believes it is probable that it will be unable to collect all amounts due according to the contractual terms of the loan agreement, as well as all loans modified into a troubled debt restructure, if any. Allowances for losses on impaired loans are determined by the lower of the present value of the expected cash flows related to the loan, using the original contractual interest rate, and its recorded value, or in the case of collateral dependent loans, the lower of the fair value of the collateral, less estimated costs to dispose, and the recorded amount of the loans. When foreclosure is probable, impairment is measured based on the fair value of the collateral less estimated costs to sell.

Details of impaired loans as of December 31, 2013 and December 31, 2012 follows:

|   | December 31, 2013      |                      |                      | December 31, 2012      |                      |                      |
|---|------------------------|----------------------|----------------------|------------------------|----------------------|----------------------|
|   | Unpaid                 |                      |                      | Unpaid                 |                      |                      |
|   | Recorded<br>Investment | Principal<br>Balance | Related<br>Allowance | Recorded<br>Investment | Principal<br>Balance | Related<br>Allowance |
| <b>With no related allowance:</b>       |                        |                      |                      |                        |                      |                      |
| Commercial real estate mortgages        | \$1,949                | \$2,103              | \$ ---               | \$2,662                | \$3,072              | \$ ---               |
| Commercial and industrial               | 660                    | 770                  | ---                  | 841                    | 966                  | ---                  |
| Commercial construction                 |                        |                      |                      |                        |                      |                      |
| and land development                    | 68                     | 68                   | ---                  | ---                    | ---                  | ---                  |
| Agricultural and other loans to farmers | 56                     | 56                   | ---                  | 664                    | 748                  | ---                  |
| Residential real estate loans           | 442                    | 442                  | ---                  | 77                     | 77                   | ---                  |
| Home equity loans                       | 21                     | 21                   | ---                  | ---                    | ---                  | ---                  |
| Other consumer                          | 13                     | 13                   | ---                  | ---                    | ---                  | ---                  |
| Subtotal                                | \$3,209                | \$3,473              | \$ ---               | \$4,244                | \$4,863              | \$ ---               |
| <b>With an allowance:</b>               |                        |                      |                      |                        |                      |                      |
| Commercial real estate mortgages        | \$ 854                 | \$ 854               | \$100                | \$ ---                 | \$ ---               | \$ ---               |
| Commercial and industrial               | 150                    | 150                  | 150                  | ---                    | ---                  | ---                  |
| Commercial construction                 |                        |                      |                      |                        |                      |                      |
| and land development                    | 1,845                  | 3,770                | 20                   | 2,359                  | 4,329                | 120                  |
| Agricultural and other loans to farmers | ---                    | ---                  | ---                  | ---                    | ---                  | ---                  |
| Residential real estate loans           | ---                    | ---                  | ---                  | ---                    | ---                  | ---                  |
| Home equity loans                       | ---                    | ---                  | ---                  | ---                    | ---                  | ---                  |
| Other consumer                          | ---                    | ---                  | ---                  | ---                    | ---                  | ---                  |
| Subtotal                                | \$2,849                | \$4,774              | \$270                | \$2,359                | \$4,329              | \$120                |
| Total                                   | \$6,058                | \$8,247              | \$270                | \$6,603                | \$9,192              | \$120                |





Details of impaired loans as of December 31, 2013, 2012, and 2011 follows:

|   | December 31, 2013<br>For the Twelve<br>Months Ended<br>Average |          | December 31, 2012<br>For the Twelve<br>Months Ended<br>Average |          | December 31, 2011<br>For the Twelve<br>Months Ended<br>Average |          |
|---|--|----------|--|----------|--|----------|
|   | Recorded   | Interest | Recorded   | Interest | Recorded   | Interest |
|   | Investment Recorded  |          | Investment Recorded  |          | Investment Recorded  |          |
| <b>With no related allowance:</b>       |  |          |  |          |  |          |
| Commercial real estate mortgages        | \$2,387  | \$ 74    | \$3,391  | \$146    | \$ 3,452   | \$105    |
| Commercial and industrial               | 689  | 6        | 813  | 8        | 1,212  | 4        |
| Commercial construction                 |  |          |  |          |  |          |
| and land development                    | 133  | ---      | 147  | ---      | 4,857  | ---      |
| Agricultural and other loans to farmers | 270  | ---      | 604  | ---      | 213  | 14       |
| Residential real estate mortgages       | 323  | 21       | 137  | 5        | 82   | ---      |
| Home equity loans                       | 17   | 2        | ---  | ---      | ---  | ---      |
| Other consumer                          | 11   | 1        | ---  | ---      | ---  | ---      |
| Subtotal                                | \$3,830  | \$104    | \$5,092  | \$159    | \$ 9,816   | \$123    |
| <b>With an allowance:</b>               |  |          |  |          |  |          |
| Commercial real estate mortgages        | \$ ---   | \$ ---   | \$ ---   | \$ ---   | \$ 396   | \$ ---   |
| Commercial and industrial               | ---  | ---      | ---  | ---      | 70   | ---      |
| Commercial construction                 |  |          |  |          |  |          |
| and land development                    | 1,967  | ---      | 3,172  | ---      | 150  | ---      |
| Agricultural and other loans to farmers | ---  | ---      | ---  | ---      | ---  | ---      |
| Residential real estate mortgages       | ---  | ---      | ---  | ---      | ---  | ---      |
| Home equity loans                       | ---  | ---      | ---  | ---      | ---  | ---      |
| Other consumer                          | ---  | ---      | ---  | ---      | ---  | ---      |
| Subtotal                                | \$1,967  | \$ ---   | \$3,172  | \$ ---   | \$ 616   | \$ ---   |
| Total                                   | \$5,797  | \$104    | \$8,264  | \$159    | \$10,432   | \$123    |

**Credit Quality Indicators/Classified Loans:** In monitoring the credit quality of the portfolio, management applies a credit quality indicator to all categories of commercial loans. These credit quality indicators range from one through nine, with a higher number correlating to increasing risk of loss. These ratings are used as inputs to the calculation of the allowance for loan losses. Loans rated one through five are consistent with the regulators' Pass ratings, and are generally allocated a lesser percentage allocation in the allowance for loan losses than loans rated from six through nine.

Consistent with regulatory guidelines, the Bank provides for the classification of loans which are considered to be of lesser quality as substandard, doubtful, or loss. The Bank considers a loan substandard if it is inadequately protected by the current net worth and paying capacity of the borrower or of the collateral pledged, if any. Substandard loans have a well defined weakness that jeopardizes liquidation of the debt. Substandard loans include those loans where there is the distinct possibility of some loss of principal, if the deficiencies are not corrected.

Loans that the Bank classifies as doubtful have all of the weaknesses inherent in those loans that are classified as substandard but also have the added characteristic that the weaknesses present make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is high but because of certain important and reasonably specific pending factors which may work to the advantage and strengthening of the loan, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors include proposed merger, acquisition, or liquidation procedures, capital injection, perfecting liens on additional collateral and refinancing plans. The entire amount of the loan might not be classified as doubtful when collection of a specific portion appears highly probable. Loans are generally not classified doubtful for an extended period of time (i.e., over a year).

Loans that the Bank classifies as loss are those considered uncollectible and of such little value that their continuance as an asset is not warranted and the uncollectible amounts are charged off. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be affected in the future. Losses are taken in the period in which they surface as uncollectible.

Loans that do not expose the Bank to risk sufficient to warrant classification in one of the aforementioned categories, but which possess some weaknesses, are designated special mention. A special mention loan has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the institution's credit position at some future date. This might include loans which the lending officer may be unable to supervise properly because of: lack of expertise, inadequate loan agreement, the poor condition of or lack of control over collateral, failure to obtain proper documentation or any other deviations from prudent lending practices. Economic or market conditions which may, in the future, affect the obligor may warrant special mention of the asset. Loans for which an adverse trend in the borrower's operations or an imbalanced position in the balance sheet which has not reached a point where the liquidation is jeopardized may be included in this classification. Special mention assets are not adversely classified and do not expose an institution to sufficient risks to warrant classification.

The following tables summarize the commercial loan portfolio as of December 31, 2013 and December 31, 2012, by credit quality indicator. Credit quality indicators are reassessed for each applicable commercial loan at least annually, or upon receipt and analysis of the borrower's financial statements, when applicable. Consumer loans, which principally consist of residential mortgage loans, are not rated, but are evaluated for credit quality after origination based on delinquency status (see past due loan aging table above).

|                          | <b>Commercial</b>  |                       | <b>Commercial</b>   | <b>Agricultural</b> |              |
|--------------------------|--------------------|-----------------------|---------------------|---------------------|--------------|
|                          | <b>real estate</b> | <b>Commercial</b>     | <b>construction</b> | <b>and other</b>    |              |
| <b>December 31, 2013</b> | <b>mortgages</b>   | <b>and industrial</b> | <b>and land</b>     | <b>loans to</b>     | <b>Total</b> |
| Pass                     | \$307,486          | \$60,330              | \$14,403            | \$26,447            | \$408,666    |
| Other Assets             |                    |                       |                     |                     |              |
| Especially Mentioned     | 19,768             | 10,568                | 437                 | 182                 | 30,955       |
| Substandard              | 9,288              | 3,074                 | 3,289               | 300                 | 15,951       |
| Doubtful                 | ---                | ---                   | ---                 | ---                 | ---          |
| Loss                     | ---                | ---                   | ---                 | ---                 | ---          |
| Total                    | \$336,542          | \$73,972              | \$18,129            | \$26,929            | \$455,572    |
|                          | <b>Commercial</b>  | <b>Commercial</b>     | <b>Commercial</b>   | <b>Agricultural</b> |              |
|                          | <b>real estate</b> | <b>and industrial</b> | <b>construction</b> | <b>and other</b>    |              |
| <b>December 31, 2012</b> | <b>mortgages</b>   | <b>and industrial</b> | <b>and land</b>     | <b>loans to</b>     | <b>Total</b> |
| Pass                     | \$293,505          | \$46,872              | \$17,469            | \$23,806            | \$381,652    |
| Other Assets             | 21,522             | 9,112                 | 2,292               | 242                 | 33,168       |

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|                      |           |          |          |          |           |
|----------------------|-----------|----------|----------|----------|-----------|
| Especially Mentioned |           |          |          |          |           |
| Substandard          | 9,466     | 3,389    | 2,359    | 874      | 16,088    |
| Doubtful             | ---       | ---      | ---      | ---      | ---       |
| Loss                 | ---       | ---      | ---      | ---      | ---       |
| Total                | \$324,493 | \$59,373 | \$22,120 | \$24,922 | \$430,908 |

**Allowance for Loan Losses:** The allowance for loan losses (the allowance) is a reserve established through a provision for loan losses (the provision) charged to expense, which represents management's best estimate of probable losses inherent within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to provide for estimated loan losses and risks inherent in the loan portfolio. The Company's allowance for loan loss methodology includes allowance allocations calculated in accordance with ASC Topic 310, *Receivables* and allowance allocations calculated in accordance with ASC Topic 450, *Contingencies*. Accordingly, the methodology is based on historical loss experience by type of credit and internal risk grade, specific homogeneous risk pools and specific loss allocations, with adjustments for current events and conditions. The Company's process for determining the appropriate level of the allowance is designed to account for credit deterioration as it occurs. The provision reflects loan quality trends, including the levels of and trends related to non-accrual loans, past due loans, potential problem loans, criticized loans and net charge-offs or recoveries, among other factors. The provision also reflects the totality of actions taken on all loans for a particular period. In other words, the amount of the provision reflects not only the necessary increases in the allowance related to newly identified criticized loans, but it also reflects actions taken related to other loans including, among other things, any necessary increases or decreases in required allowances for specific loans or loan pools.

The level of the allowance reflects management's continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. While management utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond the Company's control, including, among other things, the performance of the Company's loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications.

The Company's allowance for loan losses consists of three principal elements: (i) specific valuation allowances determined in accordance with ASC Topic 310 based on probable losses on specific loans; (ii) historical valuation allowances determined in accordance with ASC Topic 450 based on historical loan loss experience for similar loans with similar characteristics and trends, adjusted, as necessary, to reflect the impact of current conditions; and (iii) general valuation allowances determined in accordance with ASC Topic 450 based on general economic conditions and other qualitative risk factors both internal and external to the Company.

The allowances established for probable losses on specific loans are based on a regular analysis and evaluation of problem loans. Loans are classified based on an internal credit risk grading process that evaluates, among other things: (i) the obligor's ability to repay; (ii) the underlying collateral, if any; and (iii) the economic environment and industry in which the borrower operates. This analysis is performed at the relationship level for all commercial loans. When a loan has a classification of seven or higher, the Company analyzes the loan to determine whether the loan is impaired and, if impaired, the need to specifically allocate a portion of the allowance to the loan. Specific valuation allowances are determined by analyzing the borrower's ability to repay amounts owed, collateral deficiencies, the relative risk grade of the loan and economic conditions affecting the borrower's industry, among other observable considerations.

Historical valuation allowances are calculated based on the historical loss experience of specific types of loans and the internal risk grade of such loans at the time they were charged-off. The Company calculates historical loss ratios for pools of similar loans with similar characteristics based on the proportion of actual charge-offs experienced to the total population of loans in the pool. The historical loss ratios are reviewed quarterly based on actual charge-off experience.

A historical valuation allowance is established for each pool of similar loans based upon the product of the historical loss ratio and the total dollar

amount of the loans in the pool, net of any loans for which reserves are already established. The Company's pools of similar loans include similarly risk-graded groups of, commercial real estate loans, commercial and industrial loans, consumer real estate loans and consumer and other loans.

General valuation allowances are based on general economic conditions and other qualitative risk factors both internal and external to the Company. In general, such valuation allowances are determined by evaluating, among other things: (i) the experience, ability and effectiveness of the Bank's lending management and staff; (ii) the effectiveness of the Bank's loan policies, procedures and internal controls; (iii) changes in asset quality; (iv) changes in loan portfolio volume; (v) the composition and concentrations of credit; (vi) the impact of competition on loan structuring and pricing; (vii) the effectiveness of the internal loan review function; (viii) the impact of environmental risks on portfolio risks; and (ix) the impact of rising interest rates on portfolio risk. Management evaluates the degree of risk that each one of these components has on the quality of the loan portfolio on a quarterly basis. The results are then used to determine an appropriate general valuation allowance.

Loans identified as losses by management, internal loan review and/or bank examiners, are charged-off. Furthermore, consumer loan accounts are charged-off based on regulatory requirements.

The following tables detail activity in the allowance for loan losses by portfolio segment for the years ended December 31, 2013, 2012, and 2011. The tables also provide details regarding the Company's recorded investment in loans related to each balance in the allowance for loan losses by portfolio segment and disaggregated on the basis of the Company's impairment methodology. Allocation of a portion of the Allowance to one category of loans does not preclude its availability to absorb losses in other categories.

| Twelve<br>Months<br>Ended | Commercial                   |                                 |                                       |              |             | Residential | Home   | Tax    | Total    |
|---------------------------|------------------------------|---------------------------------|---------------------------------------|--------------|-------------|-------------|--------|--------|----------|
|                           | Commercial<br>Real<br>Estate | Commercial<br>and<br>Industrial | Commercial<br>and land<br>development | Agricultural | Real Estate |             |        |        |          |
| December 31,<br>2013      |                              |                                 |                                       |              |             |             |        |        |          |
| Beginning                 |                              |                                 |                                       |              |             |             |        |        |          |
| Balance                   | \$ 4,320                     | \$ 1,026                        | \$ 515                                | \$ 303       | \$ 1,330    | \$ 207      | \$ 255 | \$ 141 | \$ 8,097 |
| Charged Off               | (214)                        | (405)                           | ---                                   | (81)         | (406)       | (120)       | (29)   | ---    | (1,255)  |
| Recoveries                | 105                          | 23                              | ---                                   | 37           | 7           | 23          | 20     | ---    | 215      |
| Provision                 | 614                          | 622                             | (201)                                 | 76           | 235         | 27          | 18     | 27     | 1,418    |
| Ending                    |                              |                                 |                                       |              |             |             |        |        |          |
| Balance                   | \$ 4,825                     | \$ 1,266                        | \$ 314                                | \$ 335       | \$ 1,166    | \$ 137      | \$ 264 | \$ 168 | \$ 8,475 |
| of which:                 |                              |                                 |                                       |              |             |             |        |        |          |
| Amount for<br>loans       | \$ 100                       | \$ 150                          | \$ 20                                 | \$ ---       | \$ ---      | \$ ---      | \$ --- | \$ --- | \$ 270   |

|              |           |          |          |          |           |          |          |          |           |  |
|--------------|-----------|----------|----------|----------|-----------|----------|----------|----------|-----------|--|
| Individually |           |          |          |          |           |          |          |          |           |  |
| evaluated    |           |          |          |          |           |          |          |          |           |  |
| for          |           |          |          |          |           |          |          |          |           |  |
| impairment   |           |          |          |          |           |          |          |          |           |  |
| Amount for   |           |          |          |          |           |          |          |          |           |  |
| loans        |           |          |          |          |           |          |          |          |           |  |
| Collectively |           |          |          |          |           |          |          |          |           |  |
| evaluated    |           |          |          |          |           |          |          |          |           |  |
| for          |           |          |          |          |           |          |          |          |           |  |
| impairment   | \$ 4,725  | \$ 1,116 | \$ 294   | \$ 335   | \$ 1,166  | \$ 137   | \$ 264   | \$ 168   | \$ 8,205  |  |
| Loans        |           |          |          |          |           |          |          |          |           |  |
| individually |           |          |          |          |           |          |          |          |           |  |
| Evaluated    |           |          |          |          |           |          |          |          |           |  |
| for          |           |          |          |          |           |          |          |          |           |  |
| impairment   | \$ 2,046  | \$ 793   | \$ 1,913 | \$ 56    | \$ ---    | \$ ---   | \$ ---   | \$ ---   | \$ 4,808  |  |
| Loans        |           |          |          |          |           |          |          |          |           |  |
| collectively |           |          |          |          |           |          |          |          |           |  |
| Evaluated    |           |          |          |          |           |          |          |          |           |  |
| for          |           |          |          |          |           |          |          |          |           |  |
| impairment   | \$334,496 | \$73,179 | \$16,216 | \$26,873 | \$317,115 | \$14,523 | \$49,565 | \$16,355 | \$848,322 |  |





| Twelve<br>Months<br>Ended | Commercial<br>Real Estate | Commercial<br>and<br>Industrial | Commercial<br>Construction<br>and land<br>development | Agricultural | Residential<br>Real<br>Estate | Consumer | Home<br>Equity | Tax<br>Exempt | Total    |
|---------------------------|---------------------------|---------------------------------|---|--------------|-------------------------------|----------|----------------|---------------|----------|
| December 31, 2012         |                           |                                 |   |              |                               |          |                |               |          |
| Beginning                 |                           |                                 |   |              |                               |          |                |               |          |
| Balance                   | \$ 3,900                  | \$ 1,321                        | \$ 594  | \$ 332       | \$ 1,436                      | \$ 286   | \$ 266         | \$ 86         | \$ 8,221 |
| Charged Off               | (474)                     | (102)                           | (344)   | (160)        | (568)                         | (294)    | (92)           | ---           | (2,034)  |
| Recoveries                | 9                         | 25                              | ---   | 82           | 104                           | 38       | ---            | ---           | 258      |
| Provision                 | 885                       | (218)                           | 265   | 49           | 358                           | 177      | 81             | 55            | 1,652    |
| Ending                    |                           |                                 |   |              |                               |          |                |               |          |
| Balance                   | \$ 4,320                  | \$ 1,026                        | \$ 515  | \$ 303       | \$ 1,330                      | \$ 207   | \$ 255         | \$ 141        | \$ 8,097 |

of which:

Amount for  
loans

individually

evaluated  
for

|            |        |        |        |        |        |        |        |        |        |
|------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| impairment | \$ --- | \$ --- | \$ 120 | \$ --- | \$ --- | \$ --- | \$ --- | \$ --- | \$ 120 |
|------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|

Amount for  
loans

collectively

evaluated  
for

|            |          |          |        |        |          |        |        |        |          |
|------------|----------|----------|--------|--------|----------|--------|--------|--------|----------|
| impairment | \$ 4,320 | \$ 1,026 | \$ 395 | \$ 303 | \$ 1,330 | \$ 207 | \$ 255 | \$ 141 | \$ 7,977 |
|------------|----------|----------|--------|--------|----------|--------|--------|--------|----------|

Loans  
individually

evaluated  
for

|            |          |        |          |        |        |        |        |        |          |
|------------|----------|--------|----------|--------|--------|--------|--------|--------|----------|
| impairment | \$ 1,888 | \$ 818 | \$ 2,359 | \$ 664 | \$ --- | \$ --- | \$ --- | \$ --- | \$ 5,729 |
|------------|----------|--------|----------|--------|--------|--------|--------|--------|----------|

|                    |           |          |          |          |           |          |          |          |            |
|--------------------|-----------|----------|----------|----------|-----------|----------|----------|----------|------------|
| Loans collectively | \$322,605 | \$58,555 | \$19,761 | \$24,258 | \$297,103 | \$19,001 | \$53,303 | \$15,244 | \$ 809,830 |
|--------------------|-----------|----------|----------|----------|-----------|----------|----------|----------|------------|

evaluated  
for

impairment

| <b>Twelve<br/>Months<br/>Ended</b> | <b>Commercial</b>                 | <b>Commercial<br/>and<br/>Industrial</b> | <b>Commercial<br/>Construction<br/>and land<br/>development</b> | <b>Agricultural</b> | <b>Residential<br/>Real<br/>Estate</b> | <b>Consumer</b> | <b>Home<br/>Equity</b> | <b>Tax<br/>Exempt</b> | <b>Total</b> |
|------------------------------------|-----------------------------------|--|---|---------------------|--|-----------------|------------------------|-----------------------|--------------|
| <b>December 31,<br/>2011</b>       | <b>Commercial<br/>Real Estate</b> | <b>Industrial</b>                        | <b>Commercial<br/>Construction<br/>and land<br/>development</b> | <b>Agricultural</b> | <b>Residential<br/>Real<br/>Estate</b> | <b>Consumer</b> | <b>Home<br/>Equity</b> | <b>Tax<br/>Exempt</b> | <b>Total</b> |
| Beginning<br>Balance               | \$ 4,260                          | \$ 1,237                                 | \$ 999  | \$ 223              | \$ 1,322                               | \$ 73           | \$ 276                 | \$ 110                | \$ 8,500     |
| Charged Off                        | (423)                             | (123)                                    | (1,943)   | ---                 | (254)                                  | (90)            | (94)                   | ---                   | (2,927)      |
| Recoveries                         | 8                                 | 82                                       | 77  | 45                  | ---                                    | 41              | ---                    | ---                   | 253          |
| Provision                          | 55                                | 125                                      | 1,461   | 64                  | 368                                    | 262             | 84                     | (24)                  | 2,395        |
| Ending<br>Balance                  | \$ 3,900                          | \$ 1,321                                 | \$ 594  | \$ 332              | \$ 1,436                               | \$ 286          | \$ 266                 | \$ 86                 | \$ 8,221     |

of which:

Amount for  
loans

individually

evaluated  
for

|            |        |        |        |        |        |        |        |        |        |
|------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| impairment | \$ 100 | \$ 135 | \$ 100 | \$ --- | \$ --- | \$ --- | \$ --- | \$ --- | \$ 335 |
|------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|

Amount for  
loans

collectively

evaluated  
for

|            |          |          |        |        |          |        |        |       |          |
|------------|----------|----------|--------|--------|----------|--------|--------|-------|----------|
| impairment | \$ 3,800 | \$ 1,186 | \$ 494 | \$ 332 | \$ 1,436 | \$ 286 | \$ 266 | \$ 86 | \$ 7,886 |
|------------|----------|----------|--------|--------|----------|--------|--------|-------|----------|

Loans  
individuallyevaluated  
for

|            |          |          |          |        |        |        |        |        |          |
|------------|----------|----------|----------|--------|--------|--------|--------|--------|----------|
| impairment | \$ 2,676 | \$ 1,078 | \$ 3,753 | \$ 595 | \$ --- | \$ --- | \$ --- | \$ --- | \$ 8,102 |
|------------|----------|----------|----------|--------|--------|--------|--------|--------|----------|

|                       |           |          |           |          |           |          |          |          |           |
|-----------------------|-----------|----------|-----------|----------|-----------|----------|----------|----------|-----------|
| Loans<br>collectively | \$282,808 | \$61,372 | \$ 26,307 | \$25,985 | \$239,799 | \$22,906 | \$51,462 | \$ 9,700 | \$720,339 |
|-----------------------|-----------|----------|-----------|----------|-----------|----------|----------|----------|-----------|

evaluated  
for  
impairment

***Loan Concentrations:*** Because of the Company's proximity to Acadia National Park, a large part of the economic activity in the Bank's area is generated from the lodging and hospitality business associated with tourism. At December 31, 2013 and 2012, loans to the lodging and hospitality industry amounted to approximately \$114,982 and \$105,699, respectively.

**Loans to Related Parties:** In the ordinary course of business, the Bank has made loans at prevailing rates and terms to directors, officers and other related parties. In management's opinion, such loans do not present more than the normal risk of collectability or incorporate other unfavorable features, and were made under terms that are consistent with the Bank's lending policies.

Loan to related parties at December 31 are summarized below. Balances have been adjusted to reflect changes in status of directors and officers for each year presented.

|                        | <b>2013</b> | <b>2012</b> |
|------------------------|-------------|-------------|
| Beginning balance      | \$ 2,491    | \$ 3,077    |
| Changes in composition | 203         | ---         |
| New loans              | 1,017       | 779         |
| Less: repayments       | (377)       | (1,365)     |
| Ending balance         | \$ 3,334    | \$ 2,491    |

As of December 31, 2013, and 2012, there were no past due or non-performing loans to related parties.

#### **Note 5: Premises and Equipment**

The detail of premises and equipment as of December 31 follows:

|                                | <b>2013</b> | <b>2012</b> |
|--------------------------------|-------------|-------------|
| Land                           | \$ 2,474    | \$ 2,474    |
| Buildings and improvements     | 22,924      | 21,486      |
| Furniture and equipment        | 7,586       | 7,319       |
| Less: accumulated depreciation | (12,839)    | (12,024)    |
| Total                          | \$ 20,145   | \$ 19,255   |

Depreciation expense amounted to \$1,504, \$1,292 and \$1,180 in 2013, 2012 and 2011, respectively.

#### **Note 6: Goodwill and Other Intangible Assets**

Goodwill totaled \$4,935 at December 31, 2013 and 2012, respectively. In the third quarter of 2012, the Company recorded \$1,777 of goodwill in connection with the Bank's acquisition of substantially all of the assets and the assumption of certain liabilities including all deposits of the Border Trust Company. At December 31, 2013, the Company concluded that it is not more-likely-than-not that the fair value of the reporting unit is less than its carrying value, and goodwill is not considered impaired.

**Core Deposit Intangible Asset:** The Company has a finite-lived intangible asset capitalized on its consolidated balance sheet in the form of a core deposit intangible asset related to the Border Trust Company transaction. The core deposit intangible is being amortized over an estimated useful life of eight and one-half years and is included in other assets on the Company's consolidated balance sheet. At December 31, 2013, the balance of the core deposit intangible asset amounted to \$655.

|                                | <b>December 31,</b> | <b>December 31,</b> |
|--------------------------------|---------------------|---------------------|
| <b>(in thousands)</b>          | <b>2013</b>         | <b>2012</b>         |
| Core deposit intangibles:      |                     |                     |
| Gross carrying amount          | \$783               | \$783               |
| Less: accumulated amortization | 128                 | 36                  |
| Net carrying amount            | \$655               | \$747               |

Amortization expense on the finite-lived intangible assets is expected to total \$92 for each year from 2014 through 2020, then \$11 for 2021.

### Note 7: Income Taxes

The following table summarizes the current and deferred components of income tax expense (benefit) for each of the three years ended December 31:

|          | 2013    | 2012    | 2011    |
|----------|---------|---------|---------|
| Current  |         |         |         |
| Federal  | \$5,060 | \$4,867 | \$4,763 |
| State    | 242     | 160     | 176     |
|          | 5,302   | 5,027   | 4,939   |
| Deferred | (111)   | (83)    | (477)   |
|          | \$5,191 | \$4,944 | \$4,462 |

The following table reconciles the expected federal income tax expense (computed by applying the federal statutory tax rate of 35%) to recorded income tax expense, for each of the three years ended December 31:

|                                     | 2013    | 2012    | 2011    |
|-------------------------------------|---------|---------|---------|
| Computed tax expense                | \$6,431 | \$6,093 | \$5,427 |
| Increase (reduction) in income      |         |         |         |
| taxes resulting from:               |         |         |         |
| Officers' life insurance            | (82)    | (84)    | (88)    |
| Tax exempt interest                 | (1,199) | (1,119) | (1,015) |
| State taxes, net of federal benefit | 157     | 104     | 114     |
| Other                               | (115)   | (50)    | 24      |
|                                     | \$5,191 | \$4,944 | \$4,462 |

The tax effects of temporary differences that give rise to deferred tax assets and deferred tax liabilities at December 31, 2013 and 2012 are summarized below. The net deferred tax asset, which is included in other assets, amounted to \$8,609 at December 31, 2013 and \$442 at December 31, 2012.

| 2013  |           | 2012  |           |
|-------|-----------|-------|-----------|
| Asset | Liability | Asset | Liability |

Allowance for losses on loans and

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|                                    |          |         |         |         |
|------------------------------------|----------|---------|---------|---------|
| other real estate owned            | \$3,007  | \$ ---  | \$2,869 | \$ ---  |
| Deferred compensation              | 1,074    | ---     | 1,071   | ---     |
| Unrealized gain or loss on         |          |         |         |         |
| securities available for sale      | 3,898    | ---     | ---     | 4,173   |
| Unfunded retirement benefits       | 192      | ---     | 207     | ---     |
| Depreciation                       | ---      | 713     | ---     | 707     |
| Deferred loan origination costs    | ---      | 475     | ---     | 483     |
| Other real estate owned            | 159      | ---     | 83      | ---     |
| Non-accrual interest               | 145      | ---     | 124     | ---     |
| Write down of impaired investments | 1,641    | ---     | 1,796   | ---     |
| Branch acquisition costs and       |          |         |         |         |
| goodwill                           | ---      | 357     | ---     | 249     |
| Prepaid expenses                   | ---      | 235     | ---     | 168     |
| Other                              | 284      | 11      | 380     | 308     |
|                                    | \$10,400 | \$1,791 | \$6,530 | \$6,088 |



The Company has determined that a valuation allowance is not required for its net deferred tax asset since it is more likely than not that this asset is realizable principally through the ability to carry-back to taxable income in prior years, future reversals of existing taxable temporary differences, and future taxable income.

**Note 8: Deposits**

The aggregate amount of jumbo time deposits, each with a minimum denomination of \$100, was \$152,321 and \$130,614 at December 31, 2013 and 2012, respectively. At December 31, 2013, the scheduled maturities of jumbo certificates of deposit were as follows:

|                           |           |
|---------------------------|-----------|
| Three months or less      | \$ 30,632 |
| Over three to six months  | 40,629    |
| Over six to twelve months | 44,349    |
| Over twelve months        | 36,711    |
| Total                     | \$152,321 |

At December 31, 2013, the scheduled maturities of total time deposits were as follows:

|                   |           |
|-------------------|-----------|
| 2014              | \$237,234 |
| 2015              | 63,466    |
| 2016              | 26,293    |
| 2017              | 26,254    |
| 2018              | 42,121    |
| 2019 & thereafter | 220       |
| Total             | \$395,588 |

**Note 9: Short-term Borrowings**

The Company's short-term borrowings consist of borrowings from the Federal Home Loan Bank (the "FHLB"), and securities sold under agreements to repurchase. The following table summarizes short-term borrowings at December 31, 2013 and 2012.

|                                 | 2013      |                  | 2012      |                  |
|---------------------------------|-----------|------------------|-----------|------------------|
|                                 | Total     | Weighted Average | Total     | Weighted Average |
|                                 | Principal | Rate             | Principal | Rate             |
| Federal Home Loan Bank Advances | \$292,690 | 0.78%            | \$203,441 | 0.99%            |

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|  |           |       |           |       |
|--|-----------|-------|-----------|-------|
| Securities sold under agreements to repurchase | 20,255    | 0.29% | 20,636    | 0.32% |
| Total short-term borrowings                    | \$312,945 |       | \$224,077 |       |

**Federal Home Loan Bank Borrowings:** Information concerning short-term Federal Home Loan Bank borrowings for 2013 and 2012 is summarized below:

|   | <b>2013</b> | <b>2012</b> |
|---|-------------|-------------|
| Average daily balance during the year     | \$ 238,234  | \$182,134   |
| Maximum month-end balance during the year | \$ 292,690  | \$206,535   |
| Amount outstanding at end of year         | \$ 292,690  | \$203,441   |

All short-term FHLB advances are fixed-rate instruments. Pursuant to an agreement with the FHLB, advances are collateralized by stock in the FHLB, investment securities and a blanket lien on qualified collateral, consisting primarily of loans with first mortgages secured by one to four family properties, and other qualifying assets such as certain commercial real estate loans. All short-term advances are payable at their call date or final maturity.

**Securities Sold Under Agreements to Repurchase:** Securities sold under agreements to repurchase generally mature within one to four days from the transaction date. Information concerning securities sold under agreements to repurchase for 2013, 2012 and 2011 is summarized below:

|   | <b>2013</b> | <b>2012</b> | <b>2011</b> |
|---|-------------|-------------|-------------|
| Average daily balance during the year     | \$16,924    | \$17,946    | \$17,221    |
| Average interest rate during the year     | 0.29%       | 0.32%       | 0.55%       |
| Maximum month-end balance during the year | \$21,376    | \$23,242    | \$21,878    |
| Amount outstanding at end of year         | \$20,255    | \$20,636    | \$21,878    |

Securities collateralizing repurchase agreements, which are held in safekeeping by nonaffiliated financial institutions and not under the Bank's control, were as follows at December 31:

|                      | <b>2013</b> | <b>2012</b> | <b>2011</b> |
|----------------------|-------------|-------------|-------------|
| Carrying value       | \$35,286    | \$36,661    | \$38,716    |
| Estimated fair value | \$35,569    | \$38,227    | \$40,262    |

#### **Note 10: Long-term Debt**

A summary of long-term debt by contractual maturity is as follows:

|                      | <b>December 31, 2013</b> |             |        | <b>Range of</b>       |       |
|----------------------|--------------------------|-------------|--------|-----------------------|-------|
|                      | <b>Total</b>             | <b>Rate</b> |        | <b>Interest Rates</b> |       |
| <b>Maturity</b>      | <b>Principal</b>         | <b>Rate</b> |        |                       |       |
| 2015                 | \$ 21,000                | 2.44%       | 1.68%  | to                    | 4.70% |
| 2016                 | 11,000                   | 1.60%       | 1.17%  | to                    | 2.29% |
| 2017                 | 52,500                   | 1.74%       | -0.22% | to                    | 4.50% |
| 2018                 | 7,000                    | 1.50%       | 1.15%  | to                    | 2.25% |
| 2019 and thereafter  | ---                      | ---         | ---    | to                    | ---   |
| Total long-term debt | \$ 91,500                | 1.86%       |        |                       |       |

| <b>December 31, 2012</b> |                  |                 |        |                       |       |
|--------------------------|------------------|-----------------|--------|-----------------------|-------|
|                          | <b>Total</b>     | <b>Range of</b> |        |                       |       |
| <b>Maturity</b>          | <b>Principal</b> | <b>Rate</b>     |        | <b>Interest Rates</b> |       |
| 2014                     | \$ 53,990        | 3.24%           | 2.73%  | to                    | 4.80% |
| 2015                     | 21,000           | 2.44%           | 1.68%  | to                    | 4.70% |
| 2016                     | 11,000           | 1.60%           | 1.17%  | to                    | 2.29% |
| 2017                     | 52,500           | 1.76%           | -0.15% | to                    | 4.50% |
| 2018 and thereafter      | 4,000            | 1.75%           | 1.25%  | to                    | 2.25% |
| Total long-term debt     | \$142,490        |                 |        |                       |       |

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All of the long-term debt represents advances from the FHLB. All FHLB advances are fixed-rate instruments. Pursuant to an agreement with the FHLB, advances are collateralized by stock in the FHLB, investment securities and a blanket lien on qualified collateral, consisting primarily of loans with first mortgages secured by one to four family properties, and other qualifying assets such as qualifying commercial real estate loans. Advances are payable at their call dates or final maturity.

The maturity distribution of the long-term debt with callable features was as follows:

| <b>December 31, 2013</b>   |                  |                             |                       |    |       |
|----------------------------|------------------|-----------------------------|-----------------------|----|-------|
|                            | <b>Total</b>     | <b>Weighted<br/>Average</b> | <b>Range of</b>       |    |       |
|                            | <b>Principal</b> | <b>Rate</b>                 | <b>Interest Rates</b> |    |       |
| 2015                       | \$ 2,000         | 4.35%                       | 3.99%                 | to | 4.70% |
| 2016                       | ---              | ---                         | 0.00%                 | to | 0.00% |
| 2017                       | 28,000           | 2.17%                       | -0.22%                | to | 4.50% |
| 2018                       | 2,000            | 2.25%                       | 2.25%                 | to | 2.25% |
| 2019 and thereafter        | ---              |                             | 0.00%                 | to | 0.00% |
| Total long-term borrowings | \$32,000         | 2.31%                       |                       |    |       |

| <b>December 31, 2012</b> |                  |                             |                       |    |       |
|--------------------------|------------------|-----------------------------|-----------------------|----|-------|
|                          | <b>Total</b>     | <b>Weighted<br/>Average</b> | <b>Range of</b>       |    |       |
| <b>Maturity</b>          | <b>Principal</b> | <b>Rate</b>                 | <b>Interest Rates</b> |    |       |
| 2014                     | \$ 12,000        | 4.11%                       | 3.35%                 | to | 4.80% |
| 2015                     | 2,000            | 4.35%                       | 3.99%                 | to | 4.70% |
| 2016                     | ---              | 0.00%                       | 0.00%                 | to | 0.00% |
| 2017                     | 28,000           | 2.21%                       | -0.15%                | to | 4.50% |
| 2018 and thereafter      | 2,000            | 2.25%                       | 2.25%                 | to | 2.25% |
| Total                    | \$ 44,000        |                             |                       |    |       |

At December 31, 2013, and 2012, the Company had \$19,000 and \$31,000 of long-term debt that was currently callable, respectively. The remaining callable debt has call dates ranging from May 2014 to October 2014.

**Junior Subordinated Debentures:** In April 2008, the Company's wholly-owned subsidiary, Bar Harbor Bank & Trust (the Bank), issued \$5,000 aggregate principal amount of subordinated debentures. These debt securities qualify as Tier 2 capital for the Company and the Bank. The subordinated debt securities are due in 2023, but are callable by the

Bank after five years without penalty. The rate of interest on these debt securities is three month LIBOR plus 345 basis points. The subordinated debt securities are classified as borrowings on the Company's consolidated balance sheet. The Company incurred \$197 in costs to issue the securities and these costs are being amortized over 15 years using the interest method.

**Note 11: Shareholders' Equity**

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

capital adequacy guidelines and the regulatory frameworks for prompt corrective action, the Company and Bank must meet specific capital guidelines that involve quantitative measures of the Company's and

Bank's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Company's and Bank's capital amounts and classification are also subject to qualitative judgment by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital to risk-weighted assets and average assets. As of December 31, 2013, the Company and the Bank exceeded all capital adequacy requirements to which they are subject. As of December 31, 2013, the most recent notification from the federal regulators categorized the Bank as well-capitalized. To be categorized as well-capitalized, the Company and Bank must maintain minimum Total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the following table. There are no conditions or events since that notification that management believes have changed the Bank's or the Company's category.

The following table sets forth the Company's and the Bank's regulatory capital at December 31, 2013, under the rules applicable at that date.

|   | Consolidated |        | Adequacy Purposes |       | To be well        |        |
|---|--------------|--------|-------------------|-------|-------------------|--------|
|   | Actual       |        | Required          |       | Capitalized Under |        |
|   | Amount       | Ratio  | Amount            | Ratio | Prompt Corrective |        |
|   |              |        |                   |       | Action Provisions |        |
|   |              |        |                   |       | Amount            | Ratio  |
| <b>As of December 31, 2013</b>              |              |        |                   |       |                   |        |
| Total Capital<br>(To Risk-Weighted Assets)  |              |        |                   |       |                   |        |
| Consolidated                                | \$137,311    | 16.62% | \$66,106          | 8.00% | N/A               |        |
| Bank  | \$138,761    | 16.81% | \$66,041          | 8.00% | \$82,551          | 10.00% |
| Tier 1 Capital<br>(To Risk-Weighted Assets) |              |        |                   |       |                   |        |
| Consolidated                                | \$123,730    | 14.97% | \$33,053          | 4.00% | N/A               |        |
| Bank  | \$125,180    | 15.16% | \$33,020          | 4.00% | \$49,531          | 6.00%  |
| Tier 1 Capital<br>(To Average Assets)       |              |        |                   |       |                   |        |
| Consolidated                                | \$123,730    | 9.01%  | \$54,954          | 4.00% | N/A               |        |
| Bank  | \$125,180    | 9.12%  | \$54,923          | 4.00% | \$68,653          | 5.00%  |

The following table sets forth the Company's and the Bank's regulatory capital at December 31, 2012, under the rules applicable at that date.



|   | Consolidated Actual |        | Adequacy Purposes Required |       | To be well Capitalized Under Prompt Corrective Action Provisions Required |        |
|---|---------------------|--------|----------------------------|-------|---|--------|
|   | Amount              | Ratio  | Amount                     | Ratio | Amount  | Ratio  |
|   |                     |        |                            |       |   |        |
| <b>As of December 31, 2012</b>              |                     |        |                            |       |   |        |
| Total Capital<br>(To Risk-Weighted Assets)  |                     |        |                            |       |   |        |
| Consolidated                                | \$127,857           | 15.78% | \$64,812                   | 8.00% | N/A   |        |
| Bank  | \$128,791           | 15.92% | \$64,718                   | 8.00% | \$80,897  | 10.00% |
| Tier 1 Capital<br>(To Risk-Weighted Assets) |                     |        |                            |       |   |        |
| Consolidated                                | \$114,667           | 14.15% | \$32,406                   | 4.00% | N/A   |        |
| Bank  | \$115,601           | 14.29% | \$32,359                   | 4.00% | \$48,538  | 6.00%  |
| Tier 1 Capital<br>(To Average Assets)       |                     |        |                            |       |   |        |
| Consolidated                                | \$114,667           | 8.87%  | \$51,730                   | 4.00% | N/A   |        |
| Bank  | \$115,601           | 8.94%  | \$51,701                   | 4.00% | \$64,626  | 5.00%  |

**Dividend Limitations:** Dividends paid by the Bank are the primary source of funds available to the Company for payment of dividends to its shareholders. The Bank is subject to certain requirements imposed by federal banking laws and regulations. These requirements, among other things, establish minimum levels of capital and restrict the amount of dividends that may be distributed by the Bank to the Company. At December 31, 2013, the Bank had \$56,210 available for dividends that could be paid without prior regulatory approval.

**Stock Repurchase Plan:** In August 2008, the Company's Board of Directors approved a program to repurchase up to 300,000 shares of the Company's common stock, or approximately 10.2% of the shares then currently outstanding. The new stock repurchase program became effective as of August 21, 2008 and was authorized to continue for a period of up to twenty-four consecutive months. In August of 2010, the Company's Board of Directors authorized the continuance of this program through August 17, 2012. In August of 2012, the Company's Board of Directors authorized the continuance of this program through August 17, 2014. Depending on market conditions and other factors, these purchases may be commenced or suspended at any time, or from time to time, without prior notice and may be made in the open market or through privately negotiated transactions. As of December 31, 2013, the Company had repurchased 104,952 shares of stock under this plan, at a total cost of \$2,937 and an average price of \$27.98 per share. The Company records repurchased shares as treasury stock.

The new stock repurchase program replaced the Company's stock repurchase program that had been in place since February 2004, which had authorized the repurchase of up to 310,000 or approximately 10% of the Company's outstanding shares of common stock. As of August 19, 2008, the date this program was terminated, the Company had repurchased 288,799 shares at a total cost of \$8,441 and an average price of \$29.23 per share.

**Note 12: Stock-Based Compensation Plans:**

On October 3, 2000, the shareholders of the Company approved the Bar Harbor Bankshares and Subsidiaries Incentive Stock Option Plan of 2000 ( ISOP ) for its officers and employees, which provided for the issuance of up to 450,000 shares of common stock. The purchase price of the stock

covered by each option must be at least 100% of the trading value on the date such option was granted. Vesting terms ranged from three to seven years. According to the ISOP no option shall be granted after October 3, 2010, ten years after the effective date of the ISOP.

In May, 2009, the shareholders of the Company approved the adoption of the 2009 Bar Harbor Bankshares and Subsidiaries Equity Incentive Plan (the 2009 Plan ) for employees and directors of the Company and its subsidiaries. Subject to adjustment for stock splits, stock dividends, and similar events, the total number of shares of common stock that can be issued under the 2009 Plan over the 10 year period in which the plan will be in place is 175,000 shares of common stock, provided that no more than 75,000 shares of such stock can be awarded in the form of restricted stock or restricted stock units, as further described in the 2009 Plan. The 2009 Plan is to be administered by the Company's Compensation Committee. All employees and directors of the Company and its subsidiaries are eligible to participate in the 2009 Plan, subject to the discretion of the Administrator and the terms of the 2009 Plan. The maximum stock award granted to one individual may not exceed 20,000 shares of common stock (subject to adjustment for stock splits, and similar events) for any calendar year

In April of 2013, the Board of Directors voted a Long Term Incentive Program for senior management members. The program is designed to be made up of three year rolling plans utilizing the shares made available through the 2009 Plan. Grants may be given in time vested restricted stock awards, performance vested restricted stock awards, or a combination of both.

Compensation expense recognized in connection with the stock based compensation plans are presented in the following table for the years ended December 31, 2013, 2012, and 2011:

|   | <b>2013</b> | <b>2012</b> | <b>2011</b> |
|---|-------------|-------------|-------------|
| Stock options and restricted stock awards granted | \$265       | \$216       | \$ 99       |
| Long term performance stock                       | 63          | ---         | ---         |
| Long term restricted stock                        | 80          | ---         | ---         |
| Total compensation expense                        | \$408       | \$216       | \$ 99       |

For the years ended December 31, 2013, 2012, and 2011, the total anti-dilutive stock options amounted to 60, 36, and 117 thousand shares, respectively.

The fair value of options was estimated at the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions for stock option grants during the years ended December 31:

|                                   | <b>2013</b> | <b>2012</b> | <b>2011</b> |
|-----------------------------------|-------------|-------------|-------------|
| Risk free interest rate           | 1.55%       | 1.13%       | 2.04%       |
| Expected market volatility factor | 26.44%      | 26.08%      | 26.28%      |

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| for the Company's stock                 |         |         |         |
|---|---------|---------|---------|
| Dividend yield                          | 3.39%   | 3.40%   | 3.79%   |
| Expected life of the options (years)    | 7.0     | 6.9     | 6.8     |
| Options granted                         | 27,000  | 37,500  | 30,500  |
| Estimated fair value of options granted | \$ 6.63 | \$ 5.85 | \$ 4.99 |

The expected market price volatility for the grants during 2013 was determined by using the Company's historical stock price volatility on a daily basis during the three to seven year periods ending December 31, 2013, consistent with the expected life of the 2013 options.

**Stock Option and Restricted Stock Activity:** A summary combined status of the ISOP and the 2009 Plan as of December 31, 2013, and changes during the year then ended is presented below:

|  | Number of<br>Stock<br>Options<br>Outstanding | Exercise<br>Price Range        |         | Weighted<br>Average<br>Exercise<br>Price | Intrinsic<br>Value | Aggregate<br>Intrinsic<br>Value |
|--|--|--------------------------------|---------|--|--------------------|---------------------------------|
|  |  | From                           | To      |  |                    |                                 |
|  |  | Outstanding at January 1, 2013 | 153,418 | \$18.37                                  |                    |                                 |
| Granted  | 27,000                                       | \$35.46                        | \$40.62 | \$36.75                                  |                    |                                 |
| Exercised  | (16,361)                                     | \$18.37                        | \$37.60 | \$27.72                                  |                    |                                 |
| Cancelled  | (7,388)                                      | \$26.99                        | \$36.75 | \$29.74                                  |                    |                                 |
| Outstanding at December 31, 2013                     | 156,669                                      | \$21.82                        | \$40.62 | \$31.72                                  | \$5.56             | \$1,296                         |
| Ending vested and expected to vest December 31, 2013 | 149,084                                      | \$21.82                        | \$40.62 | \$31.91                                  | \$5.60             | \$1,206                         |
| Exercisable at December 31, 2013                     | 63,090                                       | \$21.82                        | \$37.60 | \$30.28                                  | \$5.38             | \$ 613                          |

|                                  | Number of<br>Restricted Stock<br>Awards<br>Outstanding | Weighted Average<br>Grant Date<br>Fair Value |
|----------------------------------|--|--|
|                                  | Outstanding at January 1, 2013                         | 0  |
| Awarded                          | 3,370  | \$35.80                                      |
| Released                         | (3,370)  | \$35.80                                      |
| Forfeited                        | 0  | \$ ---                                       |
| Outstanding at December 31, 2013 | 0  | \$ ---                                       |

The intrinsic value of the options exercised and cash received by the Company for options exercised for the years ended December 31, 2013, 2012, and 2011, was approximately \$201 and \$453, \$345 and \$1,174, and \$977 and \$1,363, respectively.

The tax benefit received related to the exercise of options in 2013, 2012 and 2011, was \$19, \$35 and \$248, respectively.

As of December 31, 2013, there was approximately \$298 of unrecognized compensation cost related to unvested stock option awards, net of estimated forfeitures. This amount is expected to be recognized as expense over the next seven years, with a weighted average recognition period of 3.48 years.

**Stock Options Outstanding:** The following table summarizes stock options outstanding and exercisable by exercise price range at December 31, 2013:

| Options Outstanding |         |   |   |                                       | Options Exercisable                        |   |  |
|---------------------|---------|---|---|---------------------------------------|--|---|--|
| Range of            |         | Number<br>Outstanding<br>As of 12/31/13 | Weighted Average                        |                                       | Number<br>Exercisable<br>As of<br>12/31/13 | Weighted<br>Average                     |  |
| Exercise Prices     |         |   | Remaining<br>Contractual<br>Term(years) | Weighted<br>Average<br>Exercise Price |  | Remaining<br>Contractual<br>Term(years) | Weighted<br>Average<br>Exercise<br>Price |
| \$21.82             | \$40.62 | 156,669                                 | 6.4                                     | \$31.72                               | 63,090                                     | 4.0                                     | \$30.28                                  |

During 2013, performance share awards were granted to certain executive officers providing the opportunity to earn shares of common stock of the Company ranging from zero to 10,448 shares. The performance shares granted were valued at between \$35.64 and \$36.00 the fair market value at the date of grant, and will be earned over a three year performance period. The current assumption based on the most recent peer group information results in the shares earned at 134% of the target, or 6,964 shares.

**Nonvested Performance Shares:** The following table summarizes nonvested performance shares as of December 31, 2013:

|                                  | <b>Number</b>    | <b>Weighted Average<br/>Grant Date</b> |
|----------------------------------|------------------|--|
|                                  | <b>of Shares</b> | <b>Fair Value</b>                      |
| Outstanding at January 1, 2013   | 0                | \$ ---                                 |
| Granted                          | 6,964            | 35.78                                  |
| Vested                           | 0                | ---                                    |
| Forfeited                        | 0                | ---                                    |
| Outstanding at December 31, 2013 | 6,964            | \$35.78                                |

**Nonvested Restricted Shares:** The following table summarizes nonvested performance shares as of December 31, 2013:

|                                  | <b>Number of Shares</b> | <b>Weighted Average<br/>Grant Date</b> |
|----------------------------------|-------------------------|--|
|                                  |                         | <b>Fair Value</b>                      |
| Outstanding at January 1, 2013   | 0                       | \$ ---                                 |
| Granted                          | 5,605                   | 35.74                                  |
| Vested                           | 0                       | ---                                    |
| Forfeited                        | 0                       | ---                                    |
| Outstanding at December 31, 2013 | 5,605                   | \$35.74                                |

As of December 31, 2013, there was \$355 of total unrecognized compensation cost related to nonvested nonvested restricted share awards and performance share awards granted under the Plans. That cost is expected to be recognized over a weighted average period of 2.1 years.

### **Note 13: Retirement Benefit Plans**

The Company has non-qualified supplemental executive retirement agreements with certain retired officers. The agreements provide supplemental retirement benefits payable in installments over a period of years upon retirement or death. The Company also has a supplemental executive retirement agreement with a current executive officer. This agreement provides a stream of future payments in accordance with individually defined vesting schedules upon retirement, termination, or in the event that the participating executive leaves the Company following a change of control event.

The after tax components of accumulated other comprehensive (loss) income, which have not yet been recognized in net periodic benefit cost, related to post-retirement benefits are net actuarial losses related to supplemental retirement plans of \$373 and \$401, as of December 31, 2013 and 2012, respectively.

A December 31 measurement date is used for the supplemental executive retirement plans. The following table sets forth changes in benefit obligation, changes in plan assets, and the funded status of the plans as of and for the years ended December 31:



|  | <b>Supplemental Executive</b> |             |
|--|-------------------------------|-------------|
|  | <b>Retirement Plans</b>       |             |
|  | <b>Fiscal Year Ending</b>     |             |
|  | <b>2013</b>                   | <b>2012</b> |
| <b>Obligations and Funded Status</b>                   |                               |             |
| <b>Change in Benefit Obligation</b>                    |                               |             |
| Benefit obligation at beginning of year                | \$ 3,916                      | \$ 3,349    |
| Service cost   | 209                           | 173         |
| Interest cost  | 120                           | 131         |
| Actuarial (gain) loss on supplemental retirement plans | (147)                         | 469         |
| Benefits and expenses paid                             | (216)                         | (206)       |
| Benefit obligation at end of year                      | \$ 3,882                      | \$ 3,916    |
| <b>Change in plan assets</b>                           |                               |             |
| Fair value of plan assets at beginning of year         | \$ ---                        | \$ ---      |
| Benefits and expenses paid                             | (216)                         | (206)       |
| Contributions  | 216                           | 206         |
| Fair value of plan assets at end of year               | \$ ---                        | \$ ---      |
| Funded status at end of year                           | \$(3,882)                     | \$(3,916)   |

As of December 31, 2013 and 2012, the Company had recognized liabilities of \$3,882 and \$3,916, respectively, for the supplemental executive retirement plans. These amounts are reported within other liabilities on the consolidated balance sheets.

The following table summarizes the assumptions used to determine the benefit obligations and net periodic benefit costs for the years ended December 31, 2013, 2012, and 2011:

|  | <b>Supplemental Executive</b> |             |             |
|--|-------------------------------|-------------|-------------|
|  | <b>Retirement Plans</b>       |             |             |
|  | <b>Fiscal Year Ending</b>     |             |             |
| <b>Assumptions</b>                                   | <b>2013</b>                   | <b>2012</b> | <b>2011</b> |
| Weighted-average discount rate beginning of the year | 3.14%                         | 3.76%       | 5.75%       |
| Weighted-average discount rate end of the year       | 4.02%                         | 3.14%       | 3.76%       |



The net periodic benefit cost for the years ended December 31 included the following components:

**Supplemental Executive**

**Retirement Plans  
Fiscal Year Ending  
2013      2012      2011**

**Components of Net Periodic Benefit Cost and Other  
Amounts Recognized in the Consolidated Income  
Statements**

|  |        |        |       |
|--|--------|--------|-------|
| Service cost   | \$ 209 | \$ 173 | \$ 49 |
| Interest cost  | 120    | 131    | 190   |
| Recognition of net actuarial (gain) loss               | (105)  | (139)  | 4     |
| Total recognized in the consolidated income statements | \$ 224 | \$ 165 | \$243 |

**Other Changes and Benefit Obligations Recognized in  
Other Comprehensive Income (pre-tax)**

|  |    |     |     |
|--|----|-----|-----|
| Recognition of net actuarial loss (gain)                 | 42 | 582 | (4) |
| Total recognized in other comprehensive income (pre-tax) | 42 | 582 | (4) |
| Total recognized in the consolidated income statements   |    |     |     |

|  |        |        |       |
|--|--------|--------|-------|
| and other comprehensive income (pre-tax) | \$ 266 | \$ 747 | \$239 |
|--|--------|--------|-------|

The estimated net actuarial loss for the supplemental executive retirement plan that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year is \$28.

The Company expects to contribute the following amounts to fund benefit payments under the supplemental executive retirement plans:

|                     |         |
|---------------------|---------|
| 2014                | \$ 331  |
| 2015                | 291     |
| 2016                | 291     |
| 2017                | 291     |
| 2018                | 373     |
| 2019 and thereafter | \$3,970 |

**401(k) Plan:** The Company maintains a Section 401(k) savings plan for substantially all of its employees. Employees are eligible to participate in the 401(k) Plan on the first day of any quarter following their date of hire and attainment of age 21 ½. Under the plan, the Company makes a matching contribution of a portion of the amount contributed by each participating employee, up to a percentage of the employee's annual salary. The plan allows for supplementary profit sharing contributions by the Company, at its discretion, for the benefit of participating employees. The total expense for this plan in 2013, 2012, and 2011 was \$356, \$321, and \$299, respectively.

**Note 14: Commitments and Contingent Liabilities**

The Bank is a party to financial instruments in the normal course of business to meet financing needs of its customers. These financial instruments include commitments to extend credit, unused lines of credit, and standby letters of credit.

Commitments to originate loans, including unused lines of credit, are agreements to lend to a customer provided there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not

necessarily represent future cash requirements. The Bank uses the same credit policy to make such commitments as it uses for on-balance-sheet items, such as loans. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the borrower.

The Bank guarantees the obligations or performance of customers by issuing standby letters of credit to third parties. These standby letters of credit are primarily issued in support of third party debt or obligations. The risk involved in issuing standby letters of credit is essentially the same as the credit risk involved in extending loan facilities to customers, and they are subject to the same credit origination, portfolio maintenance and management procedures in effect to monitor other credit and off-balance sheet instruments. Exposure to credit loss in the event of non-performance by the counter-party to the financial instrument for standby letters of credit is represented by the contractual amount of those instruments. Typically, these standby letters of credit have terms of five years or less and expire unused; therefore, the total amounts do not necessarily represent future cash requirements.

The following table summarizes the contractual amounts of commitments and contingent liabilities as of December 31, 2013 and 2012.

|  | <b>December 31,</b> | <b>December 31,</b> |
|--|---------------------|---------------------|
|  | <b>2013</b>         | <b>2012</b>         |
| Commitments to originate loans             | \$10,269            | \$ 20,843           |
| Unused lines of credit                     | \$98,486            | \$106,773           |
| Un-advanced portions of construction loans | \$12,203            | \$ 22,047           |
| Standby letters of credit                  | \$ 378              | \$ 307              |

As of December 31, 2013 and 2012, the fair values of the standby letters of credit were not significant to the Company's consolidated financial statements.

### *Operating Lease Obligations*

The Company leases certain properties used in operations under terms of operating leases, which include renewal options. The following table sets forth the approximate future lease payments over the remaining terms of the non-cancelable leases as of December 31, 2013.

|      |       |
|------|-------|
| 2014 | \$412 |
| 2015 | \$335 |
| 2016 | \$256 |

|                     |       |
|---------------------|-------|
| 2017                | \$136 |
| 2018                | \$139 |
| 2019 and thereafter | \$360 |

In connection the foregoing lease obligations, in 2013, 2012 and 2011, the Company recorded \$430, \$278, and \$200 in rent expense, respectively, which is included in occupancy and furniture and fixtures expense in the consolidated statements of income.

**Note 15: Fair Value Measurements**

The Company measures fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability

or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact, and (iv) willing to transact.

The Company's fair value measurements employ valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement cost). Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The Company uses a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets (Level 1 measurements) for identical assets or liabilities and the lowest priority to unobservable inputs (Level 3 measurements). The fair value hierarchy is as follows:

*Level 1* Valuation is based on unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

*Level 2* Valuation is based on quoted prices for similar instruments in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, and model-based techniques for which all significant assumptions are observable in the market.

*Level 3* Valuation is principally generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates that market participants would use in pricing the asset or liability. Valuation techniques include use of discounted cash flow models and similar techniques.

The level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement in its entirety.

The most significant instruments that the Company values are securities, all of which fall into Level 2 in the fair value hierarchy. The securities in the available for sale portfolio are priced by independent providers. In obtaining such

valuation information from third parties, the Company has evaluated their valuation methodologies used to develop the fair values in order to determine whether valuations are appropriately placed within the fair value hierarchy and whether the valuations are representative of an exit price in the Company's principal markets. The Company's principal markets for its securities portfolios are the secondary institutional markets, with an exit price that is predominantly reflective of bid level pricing in those markets. Additionally, the Company periodically tests the reasonableness of the prices provided by these third parties by obtaining fair values from other independent providers and by obtaining desk bids from a variety of institutional brokers.



A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

**Securities Available for Sale:** All securities and major categories of securities classified as available for sale are reported at fair value utilizing Level 2 inputs. For these securities, the Company obtains fair value measurements from independent pricing providers. The fair value measurements used by the pricing providers consider observable data that may include dealer quotes, market maker quotes and live trading systems. If quoted prices are not readily available, fair values are determined using matrix pricing models, or other model-based valuation techniques requiring observable inputs other than quoted prices such as market pricing spreads, credit information, callable features, cash flows, the U.S. Treasury yield curve, trade execution data, market consensus prepayment speeds, default rates, and the securities terms and conditions, among other things.

The foregoing valuation methodologies may produce fair value calculations that may not be fully indicative of net realizable value or reflective of future fair values. While Company management believes these valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

The following table summarizes financial assets and financial liabilities measured at fair value on a recurring basis as of December 31, 2013, and December 31, 2012, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

| <b>December 31, 2013</b>                                 | <b>Level 1<br/>Inputs</b> | <b>Level 2<br/>Inputs</b> | <b>Level 3<br/>Inputs</b> | <b>Total Fair<br/>Value</b> |
|--|---------------------------|---------------------------|---------------------------|-----------------------------|
| Securities available for sale:                           |                           |                           |                           |                             |
| Mortgage-backed securities:                              |                           |                           |                           |                             |
| US Government-sponsored enterprises                      | \$ ---                    | \$273,632                 | \$ ---                    | \$273,632                   |
| US Government agencies                                   | \$ ---                    | \$ 81,529                 | \$ ---                    | \$ 81,529                   |
| Private label  | \$ ---                    | \$ 6,170                  | \$ ---                    | \$ 6,170                    |
| Obligations of states and political subdivisions thereof | \$ ---                    | \$ 88,839                 | \$ ---                    | \$ 88,839                   |
|  |                           |                           |                           |                             |
| <b>December 31, 2012</b>                                 | <b>Level 1<br/>Inputs</b> | <b>Level 2<br/>Inputs</b> | <b>Level 3<br/>Inputs</b> | <b>Total Fair<br/>Value</b> |
| Securities available for sale:                           |                           |                           |                           |                             |
| Mortgage-backed securities:                              |                           |                           |                           |                             |
| US Government-sponsored enterprises                      | \$ ---                    | \$245,823                 | \$ ---                    | \$245,823                   |
| US Government agencies                                   | \$ ---                    | \$ 84,261                 | \$ ---                    | \$ 84,261                   |
| Private label  | \$ ---                    | \$ 8,113                  | \$ ---                    | \$ 8,113                    |
| Obligations of states and political subdivisions thereof | \$ ---                    | \$ 79,843                 | \$ ---                    | \$ 79,843                   |

During the years ended December 31, 2013 and 2012, there were no transfers between levels of the fair value hierarchy.

The Company also makes fair value measurements on a non-recurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment).

The following table summarizes financial assets and financial liabilities measured at fair value on a non-recurring basis as of December 31, 2013 and December 31, 2012, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value.

| <b>For the Year</b>                 | <b>Level 1</b> | <b>Level 2</b> | <b>Level 3</b> | <b>Fair Value as</b> |             |
|-------------------------------------|----------------|----------------|----------------|----------------------|-------------|
| <b>Ended 12/31/13</b>               | <b>Inputs</b>  | <b>Inputs</b>  | <b>Inputs</b>  | <b>of 12/31/13</b>   | <b>Loss</b> |
| Other real estate owned             | \$ ---         | \$ ---         | \$1,625        | \$1,625              | \$338       |
| Collateral dependent impaired loans | \$ ---         | \$ ---         | \$2,699        | \$2,699              | \$ ---      |

| <b>For the Year</b>                 | <b>Level 1</b> | <b>Level 2</b> | <b>Level 3</b> | <b>Fair Value as</b> |             |
|-------------------------------------|----------------|----------------|----------------|----------------------|-------------|
| <b>Ended 12/31/12</b>               | <b>Inputs</b>  | <b>Inputs</b>  | <b>Inputs</b>  | <b>of 12/31/12</b>   | <b>Loss</b> |
| Other real estate owned             | \$ ---         | \$ ---         | \$2,780        | \$2,780              | \$146       |
| Collateral dependent impaired loans | \$ ---         | \$ ---         | \$3,149        | \$3,149              | \$ ---      |

The Company had total collateral dependent impaired loans with carrying values of approximately \$2,699 and \$3,149 which had specific reserves included in the allowance of \$120 at December 31, 2013 and December 31, 2012. The Company measures the value of collateral dependent impaired loans using Level 3 inputs. Specifically, the Company uses the appraised value of the collateral, which is then discounted for estimated costs to dispose and other considerations. These discounts generally range from 10% to 30% of appraised value.

In estimating the fair value of OREO, the Company generally uses market appraisals less estimated costs to dispose of the property, which generally range from 10% to 30% of appraised value. Management may also make adjustments to reflect estimated fair value declines, or may apply other discounts to appraised values for unobservable factors resulting from its knowledge of the property or consideration of broker quotes. The appraisers use a market, income, and/or a cost approach in determining the value of the collateral. Therefore they have been categorized as a Level 3 measurement.

#### **Note 16: Fair Value of Financial Instruments**

The Company discloses fair value information about financial instruments for which it is practicable to estimate fair value. Fair value estimates are made as of a specific point in time based on the characteristics of the financial instruments and relevant market information. Where available, quoted market prices are used. In other cases, fair values are based on estimates using present value or other valuation techniques. These techniques involve uncertainties and are significantly affected by the assumptions used and judgments made regarding risk characteristics of various financial instruments, discount rates, estimates of future cash flows, future expected loss experience and other factors. Changes in assumptions could significantly affect these estimates. Derived fair value estimates cannot be substantiated by comparison to independent markets and, in certain cases, could not be realized in an immediate sale of the instrument.

Fair value estimates are based on existing financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Accordingly, the aggregate fair value amounts presented do not purport to represent the underlying market value of the Company.

The following describes the methods and significant assumptions used by the Company in estimating the fair values of significant financial instruments:

**Cash and cash equivalents:** For cash and cash equivalents, including cash and due from banks and other short-term investments with maturities of 90 days or less, the carrying amounts reported on the consolidated balance sheet approximate fair values.

**Federal Home Loan Bank Stock:** For Federal Home Loan Bank stock, the carrying amounts reported on the balance sheet approximate fair values.

**Loans:** For variable rate loans that re-price frequently and have no significant change in credit risk, fair values are based on carrying values. The fair value of other loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

**Deposits:** The fair value of deposits with no stated maturity is equal to the carrying amount. The fair value of time deposits is based on the discounted value of contractual cash flows, applying interest rates currently being offered on wholesale funding products of similar maturities. The fair value estimates for deposits do not include the benefit that results from the low-cost funding provided by the deposit liabilities compared to the cost of alternative forms of funding ( deposit base intangibles ).

**Borrowings:** For borrowings that mature or re-price in 90 days or less, carrying value approximates fair value. The fair value of the Company's remaining borrowings is estimated by using discounted cash flows based on current rates available for similar types of borrowing arrangements taking into account any optionality.

**Accrued interest receivable and payable:** The carrying amounts of accrued interest receivable and payable approximate their fair values.

**Off-balance sheet financial instruments:** The Company's off-balance sheet instruments consist of loan commitments and standby letters of credit. Fair values for standby letters of credit and loan commitments were insignificant.

A summary of the carrying values and estimated fair values of the Company's significant financial instruments at December 31, 2013 and 2012 follows:

|                                    | <b>Carrying<br/>Value</b> | <b>Level 1<br/>Inputs</b> | <b>Level 2<br/>Inputs</b> | <b>Level 3<br/>Inputs</b> | <b>Total<br/>Fair Value</b> |
|------------------------------------|---------------------------|---------------------------|---------------------------|---------------------------|-----------------------------|
| <b>December 31, 2013</b>           |                           |                           |                           |                           |                             |
| Financial Assets:                  |                           |                           |                           |                           |                             |
| Cash and cash equivalents          | \$ 9,200                  | \$ 9,200                  | \$ ---                    | \$ ---                    | \$ 9,200                    |
| Federal Home Loan Bank stock       | 18,370                    | ---                       | 18,370                    | ---                       | 18,370                      |
| Loans, net                         | 844,382                   | ---                       | ---                       | 850,190                   | 850,190                     |
| Interest receivable                | 4,788                     | 4,788                     | ---                       | ---                       | 4,788                       |
| Financial liabilities:             |                           |                           |                           |                           |                             |
| Deposits (with no stated maturity) | \$440,063                 | \$ ---                    | \$440,063                 | \$ ---                    | \$440,063                   |
|                                    |                           |                           |                           | ---                       |                             |
| Time deposits                      | 395,588                   | ---                       | 398,668                   |                           | 398,668                     |
| Borrowings                         | 409,445                   | ---                       | 411,298                   | ---                       | 411,298                     |
| Interest payable                   | 514                       | 514                       | ---                       | ---                       | 514                         |

|                                    | <b>Carrying<br/>Value</b> | <b>Level 1<br/>Inputs</b> | <b>Level 2<br/>Inputs</b> | <b>Level 3<br/>Inputs</b> | <b>Total Fair<br/>Value</b> |
|------------------------------------|---------------------------|---------------------------|---------------------------|---------------------------|-----------------------------|
| <b>December 31, 2012</b>           |                           |                           |                           |                           |                             |
| Financial Assets:                  |                           |                           |                           |                           |                             |
| Cash and cash equivalents          | \$ 14,992                 | \$14,992                  | \$ ---                    | \$ ---                    | \$ 14,992                   |
| Federal Home Loan Bank stock       | 18,189                    | ---                       | 18,189                    | ---                       | 18,189                      |
| Loans, net                         | 806,907                   | ---                       | ---                       | 822,675                   | 822,675                     |
| Interest receivable                | 4,502                     | 4,502                     | ---                       | ---                       | 4,502                       |
| Financial liabilities:             |                           |                           |                           |                           |                             |
| Deposits (with no stated maturity) | \$425,205                 | \$ ---                    | \$425,205                 | \$ ---                    | \$425,205                   |
| Time deposits                      | 370,560                   | ---                       | 377,427                   | ---                       | 377,427                     |
| Borrowings                         | 371,567                   | ---                       | 377,510                   | ---                       | 377,510                     |
| Interest payable                   | 684                       | 684                       | ---                       | ---                       | 684                         |

**Note 17: Legal Contingencies**

The Company and its subsidiaries are parties to certain ordinary routine litigation incidental to the normal conduct of their respective businesses, which in the opinion of management based upon currently available information will have no material effect on the Company's consolidated financial statements.

**Note 18: Condensed Financial Information Parent Company Only**

The condensed financial statements of Bar Harbor Bankshares as of December 31, 2013 and 2012, and for the years ended December 31, 2013, 2012 and 2011 are presented below:

**BALANCE SHEETS****December 31**

|                            | <b>2013</b> | <b>2012</b> |
|----------------------------|-------------|-------------|
| Cash                       | \$ 760      | \$ 538      |
| Investment in subsidiaries | 123,129     | 129,275     |
| Premises                   | 690         | 689         |
| Other assets               | 132         | 487         |
| Total assets               | \$124,711   | \$130,989   |

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|                                      |           |           |
|--------------------------------------|-----------|-----------|
| Liabilities                          |           |           |
| Total liabilities                    | \$ 3,332  | \$ 2,943  |
| Shareholders' equity                 |           |           |
| Total shareholders' equity           | \$121,379 | \$128,046 |
| Liabilities and Shareholders' equity | \$124,711 | \$130,989 |



**STATEMENTS OF INCOME****Years Ended December 31**

|  | <b>2013</b> | <b>2012</b> | <b>2011</b> |
|--|-------------|-------------|-------------|
| Dividend income from subsidiaries                    | \$ 4,883    | \$ 4,097    | \$ 4,180    |
| Equity in undistributed earnings of subsidiaries (1) | 9,468       | 9,137       | 7,505       |
| Bankshares expenses                                  | (1,591)     | (1,063)     | (865)       |
| Tax benefit  | 423         | 295         | 223         |
| Net income   | \$13,183    | \$12,466    | \$11,043    |

(1) Amount in parentheses represents the excess of dividends over net income subsidiaries.

**STATEMENTS OF CASH FLOWS****Years Ended December 31**

|   | <b>2013</b> | <b>2012</b> | <b>2011</b> |
|---|-------------|-------------|-------------|
| Cash flows from operating activities:   |             |             |             |
| Net income  | \$13,183    | \$12,466    | \$11,043    |
| Adjustments to reconcile net income to cash provided by operating activities: |             |             |             |
| Depreciation  | 1           | 3           | 42          |
| Recognition of stock based expense  | 265         | 216         | 99          |
| Net change in other assets  | 331         | (865)       | (142)       |
| Net change in other liabilities   | 389         | 663         | 144         |
| Equity in undistributed earnings of subsidiaries                              | (9,468)     | (9,137)     | (7,505)     |
| Net cash provided by operating activities                                     | 4,701       | 3,346       | 3,681       |
| Cash flows from investing activities:   |             |             |             |
| Additional investments in subsidiaries  | ---         | ---         | ---         |
| Capital expenditures  | (1)         | (3)         | (4)         |
| Net cash used in investing activities   | (1)         | (3)         | (4)         |
| Cash flows from financing activities:   |             |             |             |
| Purchases of treasury stock   | (24)        | (181)       | (623)       |
| Purchase of preferred stock and warrants                                      | ---         | ---         | ---         |
| Proceeds from issuance of equity instruments                                  | ---         | ---         | ---         |
| Proceeds from stock option exercises  | 461         | 1,187       | 1,611       |

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|  |         |         |         |
|--|---------|---------|---------|
| Dividend paid                                | (4,915) | (4,565) | (4,228) |
| Net cash used in financing activities        | (4,478) | (3,559) | (3,240) |
| Net (decrease) increase in cash              | 222     | (216)   | 437     |
| Cash and cash equivalents, beginning of year | 538     | 754     | 317     |
| Cash and cash equivalents, end of year       | \$ 760  | \$ 538  | \$ 754  |

**Note 19: Selected Quarterly Financial Data (Unaudited)**

| 2013                         | Q1       | Q2       | Q3       | Q4       | Year     |
|------------------------------|----------|----------|----------|----------|----------|
| Interest and dividend income | \$12,365 | \$12,474 | \$12,834 | \$13,076 | \$50,749 |
| Interest expense             | 3,076    | 2,991    | 2,865    | 2,731    | 11,663   |
| Net interest income          | 9,289    | 9,483    | 9,969    | 10,345   | 39,086   |
| Provision for loan losses    | 353      | 405      | 170      | 490      | 1,418    |
| Non-interest income          | 1,950    | 1,874    | 1,925    | 1,817    | 7,566    |
| Non-interest expense         | 6,307    | 6,595    | 6,835    | 7,123    | 26,860   |
| Income before income taxes   | 4,579    | 4,357    | 4,889    | 4,549    | 18,374   |
| Income taxes                 | 1,363    | 1,187    | 1,356    | 1,285    | 5,191    |
| Net income                   | \$ 3,216 | \$ 3,170 | \$ 3,533 | \$ 3,264 | \$13,183 |

**Per common share data:**

|                            |         |         |         |         |         |
|----------------------------|---------|---------|---------|---------|---------|
| Basic earnings per share   | \$ 0.82 | \$ 0.81 | \$ 0.90 | \$ 0.83 | \$ 3.35 |
| Diluted earnings per share | \$ 0.82 | \$ 0.80 | \$ 0.89 | \$ 0.82 | \$ 3.34 |

**ITEM 9A. CONTROLS AND PROCEDURES**

***Evaluation of Disclosure Controls and Procedures:*** The Company carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of its disclosure controls and procedures as of the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are designed to ensure that the information required to be disclosed by us in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and are operating in an effective manner.

***Management Report on Internal Control over Financial Reporting:*** Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting as defined in Rule 13a-15(f) and 15d-15(f) under the Exchange Act as a process designed by, or under the supervision of, the Company's principal executive and principal financial officers and effected by the Company's board of directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company;

Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and

Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2013. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ( COSO ) in *Internal Control-Integrated Framework (1992)*.

Based on its assessment, management believes that as of December 31, 2013, the Company's internal control over financial reporting is effective, based on the criteria set forth by COSO in *Internal Control Integrated Framework (1992)*.

The Company's independent registered public accounting firm has issued an audit report on the effectiveness of the Company's internal control over financial reporting. This report appears within Item 9A of this report on Form 10-K/A.

***Changes in Internal Control Over Financial Reporting:*** No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.



**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Shareholders

Bar Harbor Bankshares:

We have audited Bar Harbor Bankshares and subsidiaries (the Company) internal control over financial reporting as of December 31, 2013, based on criteria established in *Internal Control - Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying *Management Report on Internal Control Over Financial Reporting*. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on criteria established in *Internal Control - Integrated Framework (1992)* issued by COSO.

We also have audited in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Bar Harbor Bankshares and subsidiaries as of December 31, 2013 and 2012, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2013, and our report dated March 13, 2014 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Boston, Massachusetts

March 13, 2014



**PART IV**

**ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES**

3. Exhibits. See Item 15(b) to this Annual Report on Form 10-K/A.

(b) A list of exhibits to this Form 10-K/A is set forth on the Exhibit Index immediately preceding such exhibits and is incorporated herein by reference.

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this amended report to be signed on its behalf by the undersigned, thereunto duly authorized.

September 17, 2014

BAR HARBOR BANKSHARES

(Registrant)

/s/ Curtis C. Simard

Curtis C. Simard

President & Chief Executive Officer



**EXHIBIT INDEX**

The following exhibits are included as part of this Form 10-K/A.

**EXHIBIT  
NUMBER**

|      |  |                    |
|------|--|--------------------|
| 23   | Consent of Independent Registered<br>Public Accounting Firm                | Filed herewith     |
| 31.1 | Certification of Chief Executive Officer<br>under Rule 13a-14(a)/15d-14(a) | Filed herewith     |
| 31.2 | Certification of Chief Financial Officer<br>under Rule 13a-14(a)/15d-14(a) | Filed herewith     |
| 32.1 | Certification of Chief Executive Officer<br>under 18 U.S.C. Sec. 1350.     | Furnished herewith |
| 32.2 | Certification of Chief Financial Officer<br>under 18 U.S.C. Sec. 1350.     | Furnished herewith |

