

INDEPENDENT AUDITOR'S REPORT

Board of Directors and Stockholders
Idaho Bancorp and Subsidiary
Boise, Idaho

We have audited the accompanying consolidated statement of financial condition of Idaho Bancorp and Subsidiary as of December 31, 2009 and 2008, and the related consolidated statements of operations, changes in stockholders' equity, comprehensive loss, and cash flows for the years ended December 31, 2009 and 2008. These consolidated financial statements are the responsibility of Idaho Bancorp and Subsidiary's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the 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 presentations. 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 consolidated financial position of Idaho Bancorp and Subsidiary as of December 31, 2009 and 2008, and the consolidated results of their operations and their cash flows for the years ended December 31, 2009 and 2008, in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming Idaho Bancorp and Subsidiary will continue as a going concern. As discussed in Note 3 to the consolidated financial statements, the Bank has suffered recurring losses from operations and is not expected to maintain regulatory capital requirements. These conditions raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 3. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.



Spokane, Washington
March 18, 2010

**IDAHO BANCORP AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS**

As of December 31,

	<u>2009</u>	<u>2008</u>
Assets		
Cash and due from banks	\$ 4,759,746	\$ 2,584,019
Interest-bearing deposits with banks	26,485	105,150
Federal funds sold	165,950	114,698
Debt securities available for sale, at fair value	34,469,224	25,561,299
Equity securities	2,273,875	2,180,925
Loans held for sale, less unearned fees	2,380,699	4,596,327
Loans, less unearned fees	181,827,487	205,052,247
Allowance for loan losses	(8,525,554)	(4,553,183)
Net loans receivable	<u>175,682,632</u>	<u>205,095,391</u>
Accrued interest receivable	782,153	893,887
Premises and equipment, net	4,758,037	4,274,211
Deferred tax assets	-	1,990,630
Cash value of bank-owned life insurance	2,279,443	2,203,763
Other real estate owned	2,538,124	904,299
Other assets	<u>1,072,283</u>	<u>1,421,466</u>
Total assets	<u>\$ 228,807,952</u>	<u>\$ 247,329,738</u>
Liabilities		
Deposits:		
Noninterest-bearing demand	\$ 26,349,522	\$ 23,307,892
Interest-bearing demand	9,711,555	8,751,905
Savings	42,089,678	48,647,229
Time deposits of less than \$100,000	92,170,532	84,715,652
Time deposits of \$100,000 and more	<u>23,587,620</u>	<u>19,887,562</u>
Total deposits	193,908,907	185,310,240
Federal funds purchased and securities sold under agreements to repurchase	608,141	21,111,768
Subordinated debentures	7,217,000	7,217,000
Other borrowings	15,000,000	17,350,000
Accrued interest payable	514,357	594,588
Other liabilities	<u>583,704</u>	<u>752,424</u>
Total liabilities	<u>217,832,109</u>	<u>232,336,020</u>
Shareholders' Equity		
Preferred stock - Series A Cumulative Perpetual; \$1 par value; \$1,000 liquidation value; 6,900 shares authorized and issued	6,578,736	-
Preferred stock - Series B Cumulative Perpetual; \$1 par value; \$1,000 liquidation value; 345 shares authorized and issued	390,264	-
Common stock \$1.00 par value: 20,000,000 shares authorized, (At December 31, 2009: 1,877,361 issued and 1,841,128 outstanding. At December 31, 2008: 1,877,361 issued and 1,839,860 outstanding.)	1,877,361	1,877,361
Capital surplus	12,313,103	12,271,841
Treasury stock at cost (36,233 and 37,501 shares respectively)	(557,445)	(580,355)
Retained earnings/(Accumulated deficit)	(9,771,622)	2,116,680
Accumulated other comprehensive income/(loss)	<u>145,446</u>	<u>(691,809)</u>
Total shareholders' equity	<u>10,975,843</u>	<u>14,993,718</u>
Total liabilities and shareholders' equity	<u>\$ 228,807,952</u>	<u>\$ 247,329,738</u>

See accompanying notes.

IDAHO BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF OPERATIONS

For the years ended December 31,

	<u>2009</u>	<u>2008</u>
Interest income:		
Loans receivable	\$ 11,182,758	\$13,917,737
Debt securities	1,491,301	1,269,044
Interest-bearing deposits with banks	2,817	6,494
Federal funds sold	4,688	66,629
Equity security dividends	46,646	56,218
Total interest income	<u>12,728,210</u>	<u>15,316,122</u>
Interest expense:		
Deposits	3,903,624	5,376,055
Subordinated debentures	480,178	480,178
Other	617,924	889,627
Total interest expense	<u>5,001,726</u>	<u>6,745,860</u>
Net interest income	7,726,484	8,570,262
Provision for loan losses	11,258,000	4,709,000
Net interest income/(loss) after provision for loan losses	<u>(3,531,516)</u>	<u>3,861,262</u>
Noninterest income:		
Mortgage banking	1,030,118	642,825
Service charges on deposit accounts	202,414	247,289
Fee income	208,634	161,275
Loss on sale of securities	(336,991)	-
Increase in cash value of bank-owned life insurance	75,680	68,856
Other	32,302	31,429
Total noninterest income	<u>1,212,157</u>	<u>1,151,674</u>
Noninterest expense:		
Compensation and benefits	4,812,151	5,316,955
Occupancy	682,451	697,890
Equipment	325,961	309,375
Data processing services	672,991	636,177
Other services	491,669	603,374
Advertising and promotional	164,758	245,027
Travel, entertainment and education	100,227	132,354
Supplies and postage	126,220	150,690
Provision for off-balance sheet credit exposure	-	-
FDIC Insurance	473,000	151,068
Other real estate owned losses, net	360,171	-
Other	152,038	95,804
Total noninterest expense	<u>8,361,637</u>	<u>8,338,714</u>
Loss before income taxes	(10,680,996)	(3,325,778)
Income tax/(benefit)	1,014,000	(1,345,000)
Net loss	<u>\$(11,694,996)</u>	<u>\$(1,980,778)</u>
Preferred stock dividends	312,330	-
Preferred stock discount accretion, net	69,000	-
Net loss applicable to common shares	<u>\$(12,076,326)</u>	<u>\$(1,980,778)</u>
Loss per common share		
Basic	\$ (6.56)	\$ (1.08)
Diluted	(6.56)	(1.08)

See accompanying notes.

IDAHO BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

For the years ended December 31,

	Preferred Stock	Common Stock	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Total
Balance, December 31, 2007	\$ -	\$13,842,031	\$(573,922)	\$ 4,097,458	\$ 71,954	\$17,437,521
Net income/(loss)				(1,980,778)		(1,980,778)
Issuance of 26,109 shares of stock from the exercise of stock options		207,873				207,873
Tax benefit from stock options		8,325				8,325
Stock option compensation cost		92,600				92,600
Purchase of 721 shares for treasury		-	(10,248)			(10,248)
Sale of 250 shares from treasury		(1,627)	3,815			2,188
Other comprehensive income/(loss)					(763,763)	(763,763)
Balance, December 31, 2008	-	14,149,202	(580,355)	2,116,680	(691,809)	14,993,718
Net income/(loss)				(11,694,996)		(11,694,996)
Issuance of 7,245 shares of preferred stock under TARP	6,900,000					6,900,000
Amortization of Net Pref. Stk. Disc.	69,000			(69,000)		-
Preferred stock dividend payments				(124,306)		(124,306)
Stock option compensation cost		65,571				65,571
Purchase of 466 shares for treasury			(1,399)			(1,399)
Sale of 1,734 shares from treasury		(24,309)	24,309			-
Other comprehensive income/(loss)					837,255	837,255
Balance, December 31, 2009	<u>\$6,969,000</u>	<u>\$14,190,464</u>	<u>\$(557,445)</u>	<u>\$ (9,771,622)</u>	<u>\$ 145,446</u>	<u>\$10,975,843</u>

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

For the years ended December 31,

	<u>2009</u>	<u>2008</u>
Net loss	<u>\$(11,694,996)</u>	<u>\$ (1,980,778)</u>
Other comprehensive income/(loss)		
Change in net unrealized gains/(losses) on securities available for sale	1,372,906	(1,252,398)
Income tax provision/(benefit)	535,651	(488,635)
Other comprehensive income/(loss)	<u>837,255</u>	<u>(763,763)</u>
Comprehensive loss	<u>\$(10,857,741)</u>	<u>\$ (2,744,541)</u>

See accompanying notes.

IDAHO BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended December 31,

	<u>2009</u>	<u>2008</u>
Cash flows from operating activities:		
Net loss	(11,694,996)	\$ (1,980,778)
Adjustments to reconcile net income/(loss) to net cash provided/(used) by operating activities:		
Provision for loan losses	11,258,000	4,709,000
Depreciation and amortization	470,067	407,962
Other real estate owned losses, net	360,171	-
Amortization of net deferred loan origination fees	(446,599)	(624,419)
Net amortization of securities' premiums and discounts	(110,853)	14,269
Loss on sale of securities	336,991	-
Noncash stock compensation cost	65,571	92,600
Origination of loans held for sale	(54,056,163)	(36,554,163)
Proceeds from loans held for sale	56,271,790	33,570,831
Deferred income taxes	1,990,630	(1,346,960)
Increase in cash value of bank-owned life insurance	(75,680)	(68,856)
Accrued interest receivable and other assets	377,949	(529,374)
Accrued interest payable and other liabilities	(784,604)	64,418
Net cash provided/(used) by operating activities	<u>3,962,274</u>	<u>(2,245,470)</u>
Cash flows used in investing activities:		
Net change in interest-bearing deposits with banks	78,665	210,738
Net change in Federal funds sold	(51,252)	5,667,199
Purchase of securities available for sale	(17,622,586)	(12,331,777)
Maturity or call of securities available for sale	7,643,894	10,839,745
Sale of securities available for sale	2,217,537	-
Purchase of equity securities	(92,950)	(498,500)
Net change in loans receivable	13,966,860	(18,934,699)
Proceeds from sale of other real estate owned	424,874	-
Purchase of premises and equipment	(870,924)	(871,391)
Surrender of bank-owned life insurance	-	454,308
Net cash flows used in investing activities	<u>5,694,118</u>	<u>(15,464,377)</u>
Cash flows from financing activities:		
Net change in deposits	8,598,667	(3,758,868)
Net change in Federal funds purchased and securities sold under agreements to repurchase	(20,503,627)	11,895,127
Net change in other borrowings	(2,350,000)	7,550,000
Issuance of preferred stock	6,900,000	-
Preferred stock dividend payments	(124,306)	-
Tax benefit of exercise of stock options	-	8,325
Issuance of common stock	-	207,873
Purchase of treasury stock	(1,399)	(10,248)
Sale of treasury stock	-	2,188
Net cash flows from financing activities	<u>(7,480,665)</u>	<u>15,894,397</u>
Net increase (decrease) in cash and due from banks	2,175,727	(1,815,450)
Cash and due from banks, beginning of year	2,584,019	4,399,469
Cash and due from banks, end of year	<u>\$ 4,759,746</u>	<u>\$ 2,584,019</u>
Supplemental disclosure		
Cash paid for interest	\$ 5,081,957	\$ 7,036,817
Cash paid for income taxes	-	212,000
Noncash transfer of loans to other real estate owned	2,807,070	380,099
Noncash transfer of premises and equipment to other real estate owned	-	524,200
Non cash transfer of other real estate owned to premises and equipment	388,200	-

See accompanying notes.

IDAHO BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies

Nature of business:

Idaho Bancorp (the Company) was incorporated under the laws of the state of Idaho on September 30, 2004. Pursuant to a Plan of Exchange, approved by shareholders on December 7, 2004, Idaho Banking Company (the Bank) became a wholly owned subsidiary of Idaho Bancorp. Shareholders of Idaho Banking Company received one share of Idaho Bancorp stock in exchange for each share of Idaho Banking Company stock. Idaho Banking Company opened for business in 1996. The Bank's deposits are insured by the Federal Deposit Insurance Corporation (FDIC). The Bank is a member of the Federal Reserve. The Bank's primary market area is southwestern Idaho.

Basis of consolidated financial statement presentation:

The consolidated financial statements include the accounts of Idaho Bancorp and its wholly owned subsidiary Idaho Banking Company. Idaho Bancorp Statutory Trust I was formed in November 2005 to facilitate the issuance of trust-preferred securities. The Company formed Idaho Bancorp Statutory Trust II in June 2007. The accounts of Idaho Bancorp Statutory Trust I and Idaho Bancorp Statutory Trust II are not included in these consolidated financial statements. References to "Company" may be references to either Idaho Bancorp as a separate legal entity or to Idaho Bancorp as a consolidated accounting entity. The consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America.

In preparing these consolidated financial statements, the Company has evaluated events and transactions for potential recognition and disclosure through March 18, 2010, the date the consolidated financial statements were issued. In management's opinion, all accounting adjustments necessary to accurately reflect the financial position and results of operations on the accompanying consolidated financial statements have been made.

Use of estimates:

Management is required to make estimates and assumptions that affect the reported amounts of certain assets and liabilities as of the date of the balance sheets and certain income and expenses for the period. Actual results could differ, either positively or negatively, from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, other real estate owned, deferred income taxes and the estimation of depreciable lives of premises and equipment.

Reclassifications:

Certain prior year amounts have been reclassified to conform to the current presentation. These reclassifications had no impact on net income or shareholders' equity.

Cash and due from banks:

Cash and due from banks consists of vault cash, cash items in the process of collection and noninterest-bearing deposits with financial institutions. These deposits may exceed the FDIC-insured amount of \$250,000. The Company considers cash and due from banks as cash equivalents.

Interest-bearing deposits with banks:

Interest-bearing deposits with banks may consist of either demand or time deposits. Time deposits with banks generally mature within five years and are carried at cost.

Securities:

Debt securities are classified as available for sale and may be sold as part of the Company's asset and liability management strategy, to provide liquidity or for other reasons. Debt securities available for sale are carried at market value, with the unrealized gains and losses, net of income taxes, reported as a component of accumulated other comprehensive income or loss. If the value of debt securities becomes permanently impaired, those impaired securities are adjusted to the lower of cost or market through current year earnings. The Company owns stock in various banking entities, which are carried at cost.

IDAHO BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

Note 1 - Summary of Significant Accounting Policies – continued

Loans receivable:

Loans are stated at the principal amount outstanding, less net deferred loan origination fees. Interest income on loans is calculated using the simple interest method on daily balances of the principal amount outstanding, and includes the amortization of net deferred loan origination fees. Loans are considered impaired when, based on current information and events, the full collection of interest or principal is not expected within the terms of the original agreement. The accrual of interest income is discontinued when, in management's opinion, the borrower may be unable to meet payment obligations as they become due and the earned interest is reversed. The Company also follows regulatory provisions that dictate certain actions at certain stages of delinquency. Interest payments received on nonaccrual loans are applied to principal. In determining impaired status, management considers payment status, collateral value and the probability of collecting payments due according to the contractual terms of the loan agreement. Impairment on commercial or construction loans is measured on a loan-by-loan basis. Impairment may be measured by either the present value of expected future cash flows, the loan's market price, or the fair value of the collateral. Troubled debt restructured loans are those loans for which the interest rate, principal balance, collateral support or payment schedules were modified, beyond what is ordinarily available in the marketplace, to accommodate a borrower's weakened financial condition. These loans are measured for impairment at the time they are restructured. Any impairment is either specifically reserved for or charged-off. Mortgage loans originated and intended for sale are carried at the lower of cost or estimated market value. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income.

Allowance for loan losses:

The allowance for loan loss is increased by provisions charged to operations and is reduced by net loan charge-offs. The allowance for loan losses is maintained at a level considered by management adequate to provide for probable loan losses. The estimate of additions to the allowance for loan losses, and resulting charge to expense, is based upon management's continuing review. This review includes consideration of actual loan loss experience and changes in the size and character of the loan portfolio. Management evaluates known problem loans, levels of adversely classified and nonperforming loans, general economic conditions, and other relevant information in determining the proper level of the allowance. As a result of changes in economic and other conditions, it is reasonably possible that the allowance for loan losses could materially change within the year. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to recognize additions to the allowance based on their judgments of information available to them at the time of their examination. An allowance for off-balance sheet credit exposure is maintained in a separate account included in other liabilities.

Premises and equipment:

Premises and equipment are stated at cost, net of accumulated depreciation. Depreciation is charged to noninterest expense and is computed using the straight-line method over the estimated useful lives of the assets, which range from 24 months to 30 years. Maintenance and repairs are charged to occupancy or equipment expense as incurred, while improvements are capitalized.

Valuation of long-lived assets:

The Company uses its best estimates based on reasonable and supportable assumptions and projections, reviews assets for impairment whenever events or changes in circumstances have indicated that the carrying amount of its assets might not be recoverable. In accordance with ASC 360, *Property, Plant and Equipment*, impaired assets are reported at the lower of cost or fair value. At December 31, 2009 and 2008, no assets have been written down for impairment.

Other real estate owned:

Other real estate owned includes real estate acquired through foreclosure or deed taken in lieu of foreclosure. Property is recorded at market value less estimated costs to sell. Any write-down from the recorded investment to market value required at the time of foreclosure is charged to the allowance for loan losses. Subsequent write-downs and gains or losses recognized on the sale of these properties are included in noninterest income or expense.

Advertising:

Advertising costs are charged to noninterest expense as incurred. Advertising and promotional costs were \$164,758 in 2009 and \$245,027 in 2008.

IDAHO BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

Note 1 - Summary of Significant Accounting Policies – continued

Income taxes:

Deferred income taxes are reported for temporary differences between items of income or expense reported in the financial statements and those reported for income tax purposes. Deferred taxes are computed using the asset and liability approach. A valuation allowance has been established to reduce the deferred tax asset to a net realizable value.

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion of the deferred tax assets will not be realized. Management considers among other things, the scheduled reversal of deferred tax liabilities, projected future taxable income, tax planning strategies, and positions taken by taxing authorities on the various issues related to the deductibility of certain costs in making this assessment. A full valuation allowance has been recorded to reflect management's estimate of the realizable amount of its deferred tax assets at December 31, 2009.

The Bank recognizes and measures uncertain tax positions using a "more-likely-than-not" approach. The Bank's approach consisted of an analysis of its financial statements, its income tax provision, and its federal and state income tax returns. The Company analyzed its tax positions including the permanent and temporary differences as well as the major components of income and expense. As of December 31, 2009, the Bank did not believe that it had any uncertain tax positions that would rise to the level of having a material effect on its financial statements. In addition, the Bank had no accrued interest or penalties as of December 31, 2009. It is the Bank's policy to record interest and penalties as a component of income tax expense.

Stock options:

Beginning on January 1, 2006, the Company implemented ASC 718, *Compensation-Stock Compensation*, which requires the recognition of compensation cost in the financial statements of the Company. Compensation expense is recorded on a straight-line attribution basis over the vesting period of the options. The compensation expense of options is calculated using the Black-Scholes option pricing model. Stock compensation expense was \$65,571 and \$92,600 for the years ended December 31, 2009 and 2008, respectively. This had the impact of lowering 2009 and 2008 net income by \$65,571 and \$56,470, respectively. This accounting change also lowered both basic earnings per share and diluted earnings per share for 2009 and 2008 by four cents and three cents, respectively. The implementation of this new accounting standard had no impact upon the cash flow of the Company, as it was a noncash accounting entry. The accounting offset to the compensation expense was an increase in capital surplus for the same amount.

New accounting pronouncements:

In June 2009, the FASB issued SFAS 168, *The FASB Accounting Standards Codification (ASC) and the Hierarchy of Generally Accepted Accounting Principles—a replacement of FASB Statement No. 162*. The Standard established ASC 105 which establishes a single source of authoritative, nongovernmental U.S. GAAP, except for rules and interpretive releases of the SEC. The effective date of ASC 105 is for interim and annual reporting periods ending after September 15, 2009. ASC 105 is not expected to have an impact on our Company's financial position or results of operations as it does not change authoritative guidance.

In June 2009, the FASB issued SFAS 166, *Accounting for Transfers of Financial Assets*, an amendment of FASB Statement 140, SFAS No. 167 and amendments to FASB Interpretation No. 46(R). These Statements modify the accounting for transfers of financial assets and the determination of what entities must be consolidated, and will have a significant effect on securitizations and special-purpose entities. This Statement was codified under ASC 860-20, *Sale of Financial Assets* and is effective for each entity's first annual reporting period that begins after November 15, 2009, for interim periods within the first annual reporting period, and for interim and annual reporting periods thereafter. ASC 860-20 must be applied to transfers of financial assets occurring on or after the effective date. Earlier application of the amendments under ASC 860-20 is prohibited. Accordingly, the Company's transfers of financial assets will be recorded and disclosed following existing GAAP until January 1, 2010. The implementation of this new standard is not expected to have a material impact on our Company's financial statements.

IDAHO BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

Note 1 - Summary of Significant Accounting Policies – continued

In August 2009, the FASB issued ASU 2009-05, *Measuring Liabilities at Fair Value*. ASU 2009-05 is an amendment of ASC 820, *Fair Value Measurements and Disclosures*. ASU 2009-05 applies to all entities that measure liabilities at fair value within the scope of ASC 820, *Fair Value Measurements and Disclosures*. ASU 2009-05 provides guidance on measuring fair value of liabilities under circumstances in which a quoted price in an active market for the identical liability is not available. ASU 2009-05, which is effective for the first interim or annual reporting period beginning after August 28, 2009, is not expected to have a material impact on our Company's financial statements.

In September 2009, the FASB issued ASU 2009-08, *Earnings Per Share*. ASU 2009-08 is an amendment of ASC 260, *Earnings Per Share*. ASU 2009-08 provides technical corrections on computing earnings per share for a period that includes redemption or an induced conversion of a portion of a class of preferred stock. ASU 2009-08 did not have a material impact on the Company's financial statements.

Note 2 - Regulatory Agreement

On February 24, 2010, the Company entered into a Written Agreement (“Agreement”) with the Federal Reserve Bank of San Francisco and the State of Idaho Department of Finance, its principal banking regulators. The Agreement is in recognition of the common goal to maintain the financial soundness of Idaho Bancorp and its subsidiary, Idaho Banking Company (“Bank”). The Agreement is based on certain findings from an examination of the Bank concluded in July 2009 and based on financial and lending data as of March 31, 2009. The Agreement requires the Company to develop certain plans for implementing increased Board and Management oversight, as well as improving credit risk management, credit administration, asset quality and the allowance for loan and lease loss methodology. The plans are to include action items needed by the Company to meet the goals of the Agreement including strengthening its liquidity contingency plans, reducing its reliance on brokered deposits and enhancing its capital position. Additionally, the Agreement gives guidance on the payment of dividends and the redemption of debt and stock.

Note 3 - Going Concern

Idaho Bancorp (“Company”) and its subsidiary, Idaho Banking Company (“Bank”), are considered “well-capitalized” as of December 31, 2009 as discussed in Note 18. However, the Company's and Bank's capital may be eroded during 2010, to the point of falling below the “well-capitalized” designation level. The extent of the capital erosion will depend on the abilities of the Board and Management to work through the credit issues in the Bank's current loan portfolio. In an effort to maintain its “well-capitalized” designation, the Bank is reducing its risk-weighted assets and is in the process of seeking an infusion of capital from the Company's shareholders, along with new prospective shareholders.

The Bank is currently seeking \$5,000,000 of common equity through a rights offering to the Company's shareholders. This rights offering, if successful, expects to meet the necessary capital requirements for the foreseeable future. Because of the high number of banks seeking additional capital and weak investor demand for bank equities, the raising of additional capital is difficult. However, the Board of Directors and management are aggressively structuring and pricing the offering in order to attract the needed capital.

The Bank faces further risk from the economic environment in its primary market area of Ada County, Idaho. With a relatively high unemployment rate and depressed real estate market values, the Bank faces the risk of further deterioration in credit quality and unforeseen losses. Net loan charge-offs totaled \$7,285,629 in 2009. If this level of losses were to continue in 2010, the Bank would become undercapitalized without a successful rights offering.

The Bank faces additional liquidity pressures because of its current financial condition. Regulatory guidance does not permit the Bank to accept brokered deposits unless it has requested and received non-objection from the Idaho Department of Finance and the Federal Reserve Bank of San Francisco. The Bank's secured credit line at the Federal Reserve Bank has been restricted to approved overnight borrowings. In addition, the Bank cannot pay rates that exceed national averages by more than 75 basis points for deposits held at the Bank.

IDAHO BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

Note 3 - Going Concern – continued

The Bank has taken steps to reduce liquidity risk by significantly increasing liquid assets and ensuring the availability of fed funds lines with correspondent banks through pledging securities as collateral. At December 31, 2009, the Bank had approximately \$37,085,996 in liquid assets consisting of \$29,753,115 in securities, \$2,380,699 in loans held-for-sale and \$4,952,182 in cash and fed funds sold. Although \$17,000,000 of the \$29,753,115 in securities mentioned above was pledged towards the Bank's fed funds lines as collateral, this did not affect the Bank's liquidity position as no funds were drawn on the Bank's fed funds lines as of December 31, 2009. The Bank also had an additional \$32,689,214 in other liability-based liquidity available to draw upon.

While liquidity risks and asset quality risks can raise concerns about the Bank's future, the ability to raise additional capital is the most significant concern and the area of primary focus. There can be no assurance that the Bank will be able to raise additional capital. The uncertainty over obtaining additional capital raises substantial doubt regarding the Bank's ability to continue as a going concern if significant charge-offs in the loan portfolio materialize. The financial statements do not include any adjustments that may result from the outcome of these uncertainties.

Note 4 - Cash and Due from Banks

The Federal Reserve Bank requires the Bank to maintain reserve balances based upon checking account balances. These reserve balances may be kept in coin and currency or in a noninterest-bearing account with the Federal Reserve Bank. As of December 31, 2009 and 2008 the required balances were \$327,000 and \$733,000, respectively. In association with the issuance of official checks, the Company was required to keep on deposit with another financial institution, balances of \$285,000 and \$0 at December 31, 2009 and 2008, respectively.

Note 5 - Interest-bearing Deposits with Banks

The Company maintains interest-bearing deposits with other banks and depository institutions. Amounts up to \$250,000 per institution are insured by the FDIC. At December 31, 2009 and 2008, the Company had \$26,485 and \$105,150 respectively, in interest-bearing deposits with other banks.

Note 6 - Federal Funds Sold

The Company regularly sells any excess funds to financial institutions on an overnight basis. Management regularly reviews each institution's creditworthiness and financial strength. No collateral is required on these balances.

IDAHO BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

Note 7 - Debt Securities

The Company's entire securities portfolio is classified as available-for-sale to meet the additional liquidity needs associated with increasing commercial banking activities. As part of its liquidity management, the Company does not intend to classify any securities as held-to-maturity in the foreseeable future. The amortized cost, gross unrealized gains and losses and estimated market value of debt securities at December 31 are summarized below:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Estimated Market Value</u>
2009:				
Available-for-sale:				
U. S. government agencies	\$ 2,000,248	\$ 36,012	\$ -	\$ 2,036,260
Municipal bonds	7,373,166	255,465	(19,838)	7,608,793
Mortgage-backed securities	24,857,309	417,145	(450,283)	24,824,171
Total	<u>\$ 34,230,723</u>	<u>\$ 708,622</u>	<u>\$ (470,121)</u>	<u>\$ 34,469,224</u>
2008:				
Available-for-sale:				
U. S. government agencies	\$ 4,000,367	\$ 133,693	\$ -	\$ 4,134,060
Municipal bonds	7,024,871	69,012	(35,324)	7,058,559
Mortgage-backed securities	15,670,471	174,353	(1,476,144)	14,368,680
Total	<u>\$ 26,695,709</u>	<u>\$ 377,058</u>	<u>\$ (1,511,468)</u>	<u>\$ 25,561,299</u>

As shown on the previous table, there were 17 securities with gross unrealized losses of \$470,121 on available for sale debt securities at December 31, 2009. The carrying value of available-for-sale securities has been adjusted to reflect these unrealized losses. None of the unrealized losses on debt securities are related to actual credit issues but are mostly related to perceived credit risks relating to our non-agency mortgage-related securities. These securities are classified as investment grade by Moodys or S&P as of December 31, 2009 and they have been monitored monthly for credit issues. Since market perceptions and valuations can change in a relatively short period of time, these securities' unrealized losses are not considered to be permanent in nature. Therefore, none of the debt securities require an adjustment to the lower of cost or market. The following table shows gross unrealized losses by the length of time that individual securities have been in a continuous unrealized loss position at December 31, 2009.

	<u>Less than One Year</u>		<u>One Year or More</u>		<u>Total</u>	
	<u>Unrealized Loss</u>	<u>Estimated Market Value</u>	<u>Unrealized Loss</u>	<u>Estimated Market Value</u>	<u>Unrealized Loss</u>	<u>Estimated Market Value</u>
Available-for-sale:						
Municipal	\$ (19,838)	\$ 916,807	\$ -	\$ -	\$ (19,838)	\$ 916,807
Mortgage	(238,547)	10,764,236	(211,736)	2,521,313	(450,283)	13,285,549
Total	<u>\$ (258,385)</u>	<u>\$ 11,681,043</u>	<u>\$ (211,736)</u>	<u>\$ 2,521,313</u>	<u>\$ (470,121)</u>	<u>\$ 14,202,356</u>

IDAHO BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

Note 7 - Debt Securities – continued

The following table shows gross unrealized losses by the length of time that individual securities were in a continuous unrealized loss position at December 31, 2008.

	<u>Less than One Year</u>		<u>One Year or More</u>		<u>Total</u>	
	<u>Unrealized</u>	<u>Estimated</u>	<u>Unrealized</u>	<u>Estimated</u>	<u>Unrealized</u>	<u>Estimated</u>
Available-for-sale:						
Municipal	\$ (31,692)	\$ 1,336,736	\$ (3,632)	\$ 246,368	\$ (35,324)	\$ 1,583,104
Mortgage	(1,476,144)	4,680,296	-	-	(1,476,144)	4,680,296
Total	<u>\$ (1,507,836)</u>	<u>\$ 6,017,032</u>	<u>\$ (3,632)</u>	<u>\$ 246,368</u>	<u>\$ (1,511,468)</u>	<u>\$ 6,263,400</u>

During 2009 and 2008, proceeds received from the sale of available for sale securities were \$2,217,537 and \$0, respectively. Three securities were sold in 2009 which resulted in a net loss of \$336,991. No securities were sold in 2008.

Maturities of debt securities at December 31, 2009, are summarized below. Actual maturities may differ from contractual maturities due to call provisions.

	<u>Available-for-Sale</u>	
	<u>Amortized Cost</u>	<u>Estimated Market Value</u>
U. S. government agencies and municipal bonds		
Maturing within one year	\$ 2,673,359	\$ 2,721,564
Maturing after one but within five years	3,300,053	3,462,477
Maturing after five but within ten years	1,871,558	1,934,409
Maturing after ten years	1,528,444	1,526,603
Total	<u>9,373,414</u>	<u>9,645,053</u>
Mortgage-backed securities	<u>24,857,309</u>	<u>24,824,171</u>
Total	<u>\$ 34,230,723</u>	<u>\$ 34,469,224</u>

The estimated market value of pledged securities as of December 31, 2009 totaled \$22,695,098, consisting of \$87,745 as collateral for the Bank's credit line at Federal Home Loan Bank of Seattle, \$1,256,129 pledged to the Bank's customers who have repurchase agreements with the Bank, \$8,266,391 pledged to Bankers' Bank of the West for a secured fed funds line, \$6,273,702 pledged to Pacific Coast Bankers' Bank for a secured fed funds line and \$6,811,131 pledged to Zions Bank for a secured fed funds line. The estimated market value of pledged securities as of December 31, 2008 totaled \$19,670,838, consisting of \$11,660,187 as collateral for the Bank's credit line at Federal Home Loan Bank of Seattle and \$8,010,651 pledged to the Bank's customers who had repurchase agreements with the Bank.

IDAHO BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

Note 8 - Equity Securities

The Company owns stock in various banking entities. The Federal Home Loan Bank of Seattle requires the Bank to purchase stock of the Federal Home Loan Bank based upon the Bank's residential mortgage loans and securities and the amount of borrowings from the Federal Home Loan Bank. As of December 31, 2009 and 2008, the required stock holdings were \$675,000 and \$1,192,800, respectively. The Bank is not restricted from selling its excess stock, but the excess stock provides the ability to borrow additional funds from the Federal Home Loan Bank of Seattle. The Bank is required to own stock in the Federal Reserve Bank of San Francisco based upon the Bank's capital and surplus. The following equity securities were owned as of December 31 and are recorded at cost:

	<u>2009</u>	<u>2008</u>
Federal Home Loan Bank of Seattle	\$ 1,222,500	\$ 1,222,500
Federal Reserve Bank of San Francisco	649,450	556,500
Bankers' Bank of the West Bancorp, Inc.	211,925	211,925
Pacific Coast Bankers' Bancshares	190,000	190,000
Total	<u>\$ 2,273,875</u>	<u>\$ 2,180,925</u>

Note 9 - Loans Receivable and Allowance for Loan Losses

The following are major categories of loans outstanding at December 31:

	<u>2009</u>		<u>2008</u>	
	<u>Amount</u>	<u>Percent</u>	<u>Amount</u>	<u>Percent</u>
Real estate loans	\$ 135,097,563	76.9%	\$ 150,483,928	73.4%
Commercial loans	44,327,391	25.2%	52,124,782	25.4%
Consumer loans	2,926,564	1.7%	3,142,245	1.5%
	182,351,518	103.8%	205,750,955	100.3%
Deferred loan origination fees	(524,031)	-0.3%	(698,708)	-0.3%
	\$ 181,827,487	103.5%	\$ 205,052,247	100.0%
Loans held for sale	2,380,699	1.4%	4,596,327	2.2%
Allowance for loan losses	(8,525,554)	-4.9%	(4,553,183)	-2.2%
Net loans receivable	<u>\$ 175,682,632</u>	<u>100.0%</u>	<u>\$ 205,095,391</u>	<u>100.0%</u>

Rates on loans receivable can either be fixed or vary according to changes in various indexes. At December 31, 2009, 82% of loans receivable had variable interest rates, compared to 82% on December 31, 2008.

The Company's loans are primarily to customers within Idaho. Credit risk on loans is managed through limits on amounts loaned to individual borrowers, underwriting standards and loan monitoring procedures. Collateral for loans varies, but may include real estate, equipment, accounts receivable, inventory, and securities. The Company's interest in collateral is obtained through filing mortgages and liens, and some cases, by possession of the collateral.

Nonperforming loans are loans that are 90 days past due and still accruing interest or loans that are on nonaccrual status. Nonperforming loans that were 90 days past due and still accruing interest did not exist at December 31, 2009 and 2008, respectively. Commitments to lend additional funds to customers with troubled debt restructured loans did not exist at December 31, 2009. Nonperforming assets are nonperforming loans and repossessed collateral, either real estate or personal property. At December 31, 2009, the Company had nonperforming assets of \$24,934,542 with specific reserves of \$4,603,470. Nonperforming assets of \$11,287,407 with specific reserves of \$2,214,651 existed at December 31, 2008. All nonperforming assets were written down to the lower of cost or market value as of December 31, 2009, and as a result, no additional funds were reserved.

IDAHO BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

Note 9 - Loans Receivable and Allowance for Loan Losses – continued

Included in the Bank's nonperforming assets at December 31, 2009 were impaired loans of \$22,396,418 and retaken other real estate owned of \$2,538,124. The total impaired loans at December 31, 2009 were \$47,529,367 with associated specific reserves of \$4,825,443. The Company had impaired loans of \$10,907,308 with specific reserves of \$2,214,651 at December 31, 2008.

The table below shows the year-to-date 2009 and 2008 average impaired loans and interest collected on those loans:

	<u>2009</u>	<u>2008</u>
Average impaired loans	\$ 12,761,892	\$ 574,300
Interest collected since impairment	\$ -	\$ -

The activity in the allowance for loan losses for the years ended December 31:

	<u>2009</u>	<u>2008</u>
Balance, beginning of year	\$ 4,553,183	\$ 2,622,937
Loan charge-offs	(7,391,316)	(2,822,477)
Loan recoveries	105,687	43,723
Net loan recoveries/(charge-offs)	(7,285,629)	(2,778,754)
Provision charged to expense	11,258,000	4,709,000
Balance, end of year	<u>\$ 8,525,554</u>	<u>\$ 4,553,183</u>
Allowance as a % of loans receivable, net of deferred fees	4.63%	2.17%

The Company has made loans in the ordinary course of business, to certain directors, executive officers and principal shareholders of the Company. Loan activity to those parties for years ended December 31:

	<u>2009</u>	<u>2008</u>
Balance, beginning of year	\$ 1,299,388	\$ 848,789
Advances	7,714,926	9,449,563
Payments	(6,745,444)	(8,998,964)
Balance, end of year	<u>\$ 2,268,870</u>	<u>\$ 1,299,388</u>

Note 10 - Premises and Equipment

The following is a summary of premises and equipment at December 31:

	<u>2009</u>	<u>2008</u>
Land	\$ 1,598,146	\$ 1,209,946
Building improvements	3,205,399	3,205,399
Construction in progress	-	3,270
Furniture, fixtures and equipment	2,698,962	2,160,788
Total cost	7,502,507	6,579,403
Accumulated depreciation and amortization	(2,744,470)	(2,305,192)
Premises and equipment, net	<u>\$ 4,758,037</u>	<u>\$ 4,274,211</u>

Depreciation and amortization expense for the years ended December 31, 2009 and 2008 was \$395,097 and \$364,230, respectively.

IDAHO BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

Note 11 - Cash Value of Bank-Owned Life Insurance

The Company has purchased life insurance policies on selected directors and officers of the Company. The policies were purchased by paying a one-time premium. The premiums paid are reflected as an asset of the Company, as they represent the cash surrender value of the life insurance policies. The asset is increased as the cash value of the policies increase, and that increase is reflected as noninterest income. The Company regularly evaluates the credit worthiness of the insurance companies that issued the policies. Certain employees and directors have been offered split-dollar death benefits. Under those agreements, employees or directors may direct a portion of the death benefits to the beneficiaries of their choice. Income on the increase in cash value is being recorded as tax-free income. No surrender of policies occurred in 2009, whereas the surrender of policies in 2008 resulted in positive cash flows of \$454,308 and a corresponding tax consequence of \$20,388 for 2008. The following schedule shows the potential death benefits available as of December 31:

	<u>2009</u>	<u>2008</u>
Death benefits under bank-owned life insurance policies	\$ 4,983,270	\$ 4,936,696
Split dollar benefits payable to beneficiaries	(1,730,000)	(1,710,000)
Cash value of bank-owned life insurance	<u>(2,279,443)</u>	<u>(2,203,763)</u>
Net benefit to the Company	<u>\$ 973,827</u>	<u>\$ 1,022,933</u>

Note 12 - Deposits

The scheduled maturity of time deposits at December 31, 2009, is shown below:

Year ending December 31:	<u>Amount</u>	<u>Percent</u>
2010	\$ 83,822,490	72.4%
2011	19,033,756	16.4%
2012	10,364,274	9.0%
2013	611,371	0.5%
2014	<u>2,043,694</u>	<u>1.8%</u>
	115,875,585	100.1%
Deferred fees	<u>(117,433)</u>	<u>-0.1%</u>
Net time deposits	<u>\$ 115,758,152</u>	<u>100.0%</u>

Deposits owned by directors, executive officers, or principal shareholders were \$4,280,791 and \$3,406,386 as of December 31, 2009 and December 31, 2008, respectively.

Note 13 - Federal Funds Purchased and Securities Sold Under Agreements to Repurchase

The Company periodically purchases federal funds on a secured and an unsecured overnight basis from other financial institutions. The Company has agreements allowing for the purchase of up to \$30,271,895 of federal funds. The Company routinely enters into sales of securities to certain of its customers with simultaneous agreements to repurchase those securities. Balances and rate information for Federal funds purchased and securities sold under agreements to repurchase for the years ended December 31 is as follows:

	<u>2009</u>	<u>2008</u>
Average balance during the year	\$ 6,432,794	\$ 15,019,900
Average interest rate during the year	0.46%	1.98%
Maximum month-end balance during the year	\$ 14,631,311	\$ 22,199,506
Year-end balance of securities sold under agreement to repurchase	\$ 1,185,581	\$ 8,010,651
Year-end estimated market value of securities underlying agreements	1,256,129	8,263,903

IDAHO BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

Note 14 - Subordinated Debentures and Other Borrowings

In November 2005 the Company issued junior subordinated debentures of \$4,124,000 to Idaho Bancorp Statutory Trust I (the Trust). These debentures mature on December 15, 2035, and carry a fixed interest rate of 6.32% until December 15, 2010. After that date, the interest rate converts to a variable rate of three-month LIBOR plus 1.42%, repricing quarterly. The debentures can be redeemed, at par, in whole or in part at the option of the Company on or after December 15, 2010. The Trust's major asset is the debentures receivable from the Company. The Trust's major liability is \$4,000,000 of securities issued to third party investors with the same terms as the debentures between the Company and the Trust. The Company has provided a full and unconditional guarantee of the securities issued by the Trust. The Trust also has \$124,000 of equity capital, which is reflected in the Company's assets as an investment in the Trust. Pursuant to financial accounting standards (ASC 810), the Trust is not included in these consolidated financial statements. For regulatory capital purposes, the \$4,124,000 of debentures issued to the Trust, less the \$124,000 capital investment in the Trust, are included in Tier 1 regulatory capital.

In June 2007 the Company issued junior subordinated debentures of \$3,093,000 to Idaho Bancorp Statutory Trust II (the Trust). These debentures mature on September 15, 2037, and carry a fixed interest rate of 7.098% until September 15, 2012. After that date, the interest rate converts to a variable rate of three-month LIBOR plus 1.55%, repricing quarterly. The debentures can be redeemed, at par, in whole or in part at the option of the Company on or after September 15, 2012. The Trust's major asset is the debentures receivable from the Company. The Trust's major liability is \$3,000,000 of securities issued to third party investors with the same terms as the debentures between the Company and the Trust. The Company has provided a full and unconditional guarantee of the securities issued by the Trust. The Trust also has \$93,000 of equity capital, which is reflected in the Company's assets as an investment in the Trust. Pursuant to financial accounting standards (FIN No. 46), the Trust is not included in these consolidated financial statements. For regulatory capital purposes, the \$3,093,000 of debentures issued to the Trust, less the \$93,000 capital investment in the Trust, are included in Tier 1 regulatory capital.

The Agreement referenced in Note 2 requires the Bank to defer interest payments for the two subordinated debentures mentioned above. At December 31, 2009, the Bank was in arrears by approximately \$130,318 for Idaho Bancorp Statutory Trust I and approximately \$54,885 for Idaho Bancorp Statutory Trust II. Although these payments have been deferred, they have still been recognized as interest expense and accrued by the Bank.

The Bank can borrow up to 20% of its assets from the Federal Home Loan Bank of Seattle. These advances must be collateralized with certain mortgage based assets or securities. As of December 31, 2009, loans of \$60,758,706 and securities with an estimated fair value of \$87,745 were available to meet collateral requirements. The pledged securities were held in a collateral account at the Federal Home Loan Bank to secure borrowings. The securities in the collateral account in excess of collateral requirements are not restricted and can be withdrawn at any time. At December 31, 2009, the Bank had \$15,000,000 of term borrowings from the Federal Home Loan Bank. This compares with term borrowings of \$17,350,000 on December 31, 2008. Term borrowings from the Federal Home Loan Bank have penalties for early payment. The weighted average rates and scheduled repayment dates of the term borrowings at December 31, 2009, are as follows:

Year ending December 31:	<u>Amount</u>	<u>Average Rate</u>
2010	\$ 4,000,000	3.39%
2011	\$ 3,000,000	3.38%
2012	\$ 6,000,000	3.61%
2013	\$ 2,000,000	4.54%
Total	<u>\$ 15,000,000</u>	3.63%

IDAHO BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

Note 15 - Income Taxes

The Company's federal statutory income tax rate is 34%. The state statutory income tax rate is 7.6%. The state income tax rate, net of the federal tax benefit, is 5.016%. The difference between income taxes at the federal tax rate and the Company's actual provision is explained below for years ended December 31:

	<u>2009</u>	<u>2008</u>
Income taxes at Federal statutory rate of 34%	\$ (3,631,539)	\$ (1,130,765)
Income taxes at net state statutory rate of 5.016%	(390,567)	(165,180)
Tax exempt interest and dividend income	(68,453)	(70,420)
Tax exempt income on bank-owned life insurance	(25,734)	(23,411)
Taxable income on surrender of bank-owned life insurance	-	20,388
Nondeductible expenses	9,380	8,928
Change in valuation allowance	5,120,913	-
Other	-	15,460
Income tax expense/(benefit)	<u>\$ 1,014,000</u>	<u>\$ (1,345,000)</u>

Deferred and current components of income taxes for years ended December 31 are as follows:

	<u>2009</u>	<u>2008</u>
Current		
Federal	\$ (464,604)	\$ (364,415)
State	(69,425)	(189,175)
Deferred		
Federal	(3,108,410)	(657,534)
State	(464,474)	(133,876)
Change in valuation allowance	5,120,913	-
Income tax expense/(benefit)	<u>\$ 1,014,000</u>	<u>\$ (1,345,000)</u>

IDAHO BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

Note 15 - Income Taxes - continued

A summary of deferred tax assets and liabilities at December 31 follows:

	<u>2009</u>	<u>2008</u>
Deferred tax assets:		
AMT credit carry forward	\$ 38,541	\$ -
Net operating loss carry forward	2,494,743	95,333
Unrealized gain/(loss) on securities available-for-sale	-	442,601
Directors' retirement payable	273	58,081
Other real estate owned	115,746	-
Goodwill	13,493	25,521
Reserve for loan losses	2,639,414	1,549,612
Other	<u>138,418</u>	<u>117,638</u>
Total deferred income tax assets before valuation allowance	5,440,628	2,288,786
Less valuation allowance	<u>(5,120,913)</u>	<u>-</u>
Total deferred income tax assets	<u>319,715</u>	<u>2,288,786</u>
Deferred tax liabilities:		
Book tax depreciation	(191,835)	(262,534)
Federal Home Loan Bank stock dividends	(35,622)	(35,622)
Unrealized gain/(loss) on securities available-for-sale	(93,054)	-
Other	<u>(92,258)</u>	<u>-</u>
Total deferred income tax liabilities	<u>(412,769)</u>	<u>(298,156)</u>
Net deferred tax assets/(liability)	<u>\$ (93,054)</u>	<u>\$ 1,990,630</u>

The Company files income tax returns in the U.S. federal jurisdiction and Idaho. The Company is no longer subject to U.S. federal, state and local tax authorities for years before 2006. The Company does not have any uncertain tax positions. As of December 31, 2009, there is no accrued interest or penalties recorded in the financial statements.

Note 16 - Earnings Per Share

Basic earnings per share are computed by dividing net income available to common shareholders by the weighted average number of shares of common stock outstanding. Diluted earnings per share are computed by dividing net income available to common shareholders by the number of shares outstanding, increased by additional shares considering the dilutive effect of stock options. The dilutive effect of the stock options is calculated by assuming that shares are issued for all stock options, offset by the tax benefit of options and by the purchase of treasury stock at current market prices. However, net losses are anti-dilutive and therefore no dilutive effect is recognized for either 2009 or 2008.

Calculations for the years ending December 31 follow:

	<u>2009</u>	<u>2008</u>
Net loss applicable to common shares	<u>\$ (12,076,326)</u>	<u>\$ (1,980,778)</u>
Weighted average shares outstanding for basic calculations	1,840,631	1,830,771
Effect of dilutive stock options	-	-
Weighted average shares for diluted calculations	<u>1,840,631</u>	<u>1,830,771</u>
Basic loss per common share	\$ (6.56)	\$ (1.08)
Diluted loss per common share	(6.56)	(1.08)

IDAHO BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

Note 17 - Commitments

The Company has entered into various operating leases for property and equipment. Some lease payments adjust annually and some leases contain renewal options. Rental expense was \$358,311 and \$405,421 for 2009 and 2008, respectively. The future minimum annual rental payments, assuming no renewal options and known escalation rates, are summarized below.

Year ending December 31:	
2010	\$ 284,926
2011	122,947
2012	<u>21,520</u>
Total	<u>\$ 429,393</u>

In the normal course of business, the Company makes commitments to extend credit that are not presented in the accompanying balance sheets. These loan commitments are agreements to lend to a customer, as long as there is no violation of any condition established in the contract. The commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of these commitments are expected to expire without being fully drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Commitments are primarily to customers within Idaho. The Company's exposure to loan loss in the event of nonperformance by the customer is represented by the commitment amount. To control this credit risk, the Company uses the same underwriting standards that it uses for loans recorded on the balance sheet. The Company maintains an allowance in other liabilities for possible loss on off-balance sheet credit exposure. A summary of commitments and the allowance at December 31 follows:

	<u>2009</u>	<u>2008</u>
Loan commitments exceeding one year	\$ 28,397,267	\$ 39,658,294
Loan commitments of one year or less	8,157,034	10,865,599
Letters of credit	2,791,335	1,983,192
Allowance for off-balance sheet credit exposure	75,000	75,000

Note 18 - Shareholders' Equity and Regulatory Matters

The Company has never paid cash dividends on its common stock and does not intend to pay cash dividends in the foreseeable future. The Company paid cash dividends of \$114,043 and \$10,263 on its fixed rate cumulative perpetual preferred stock, series A and series B, respectively, which was issued for the receipt of \$6,900,000 in funds from the United States Treasury as part of the Troubled Asset Relief Program's Capital Purchase Program. Due to the Agreement discussed in Note 2, the Company is in arrears for payments of dividends on its preferred stock, series A in the amount of \$172,500 (\$25/share) and series B in the amount \$15,524 (\$45/share). The Company owes interest for deferred dividend payments for preferred stock series A and series B in the amounts of \$3,248 and \$528, respectively. Since the Company has no source of outside income, it is dependent upon dividends received from the Bank to meet its cash needs. Banking regulations restrict the amount of cash dividends that can be paid by the Bank to the Company. The Bank paid cash dividends to the Company of \$400,000 in 2009 and \$10,000 in 2008. The Bank's dividends to the Company in 2010 can not exceed the year-to-date net income in 2010 at the time of the dividend declaration.

The Company sold 1,734 shares of Treasury stock in 2009, at an average price of \$14.02. The Company also purchased 466 shares of Treasury stock in 2009, at an average cost of \$3.00 under its stock repurchase plan.

As of December 31, 2009 and 2008, 36,233 and 37,501 shares, respectively, were held in treasury at an average cost of \$15.38 and \$15.46, respectively.

Both the Company and the Bank are subject to various regulatory capital requirements, as administered by federal and state banking agencies. The failure to meet minimum capital requirements can cause regulators to initiate certain actions that could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines. Those guidelines

IDAHO BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

Note 18 - Shareholders' Equity and Regulatory Matters – continued

involve quantitative measures of assets and certain off-balance-sheet items. Capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

The following calculations show for both the consolidated Company and for the Bank the calculation of regulatory capital ratios as of December 31, 2009:

	<u>Consolidated</u>	<u>Bank Only</u>
Capital for financial reporting purposes	\$ 10,975,843	\$ 17,958,656
Accumulated other comprehensive income	(145,446)	(145,446)
Subordinated debentures	7,217,000	-
Investment in Idaho Bancorp Statutory Trust I	(124,000)	-
Investment in Idaho Bancorp Statutory Trust II	(93,000)	-
	<hr/>	<hr/>
Tier 1 regulatory capital	17,830,397	17,813,210
Tier 2 permitted allowances	2,594,479	2,593,115
	<hr/>	<hr/>
Total risk-based regulatory capital	<u>\$ 20,424,876</u>	<u>\$ 20,406,325</u>
	<hr/>	<hr/>
Total risk-based capital	\$ 20,424,876	\$ 20,406,325
Risk weighted assets	201,552,227	201,441,797
Total risk-based capital ratio	10.13%	10.13%
	<hr/>	<hr/>
Tier 1 risk-based capital	\$ 17,830,397	\$ 17,813,210
Risk weighted assets	201,552,227	201,441,797
Tier 1 risk-based capital ratio	8.85%	8.84%
	<hr/>	<hr/>
Tier 1 regulatory capital	\$ 17,830,397	\$ 17,813,210
Quarterly average assets	238,410,926	238,018,199
Risk-based leverage ratio	7.48%	7.48%

Quantitative measures established by regulation to ensure capital adequacy require the Company and Bank to maintain minimum amounts and ratios. Management believes, as of December 31, 2009, that the Company and Bank meet all capital adequacy requirements to which they are subject. The most recent notification from the Federal Reserve Bank and the State of Idaho, dated September 25, 2009, categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Bank must maintain minimum amounts and ratios as set forth in the table below. A further erosion of the Company's and Bank's capital during 2010 could lead to an adequately-capitalized designation under the regulatory framework for prompt corrective action.

IDAHO BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

Note 18 - Shareholders' Equity and Regulatory Matters – continued

Idaho Banking Company's required and actual capital amounts and ratios at December 31 are presented below:

	Required to be "Adequately Capitalized"		Required to be "Well Capitalized"		Actual	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
2009:						
Total risk-based capital	\$ 16,115,344	8.00%	\$ 20,144,180	10.00%	\$ 20,406,325	10.13%
Tier 1 risk-based capital	8,057,672	4.00%	12,086,508	6.00%	17,813,210	8.84%
Risk-based leverage	9,520,728	4.00%	11,900,910	5.00%	17,813,210	7.48%
2008:						
Total risk-based capital	\$ 18,830,744	8.00%	\$ 23,538,431	10.00%	\$ 25,141,813	10.68%
Tier 1 risk-based capital	9,415,372	4.00%	14,123,058	6.00%	22,178,696	9.42%
Risk-based leverage	9,665,128	4.00%	12,081,410	5.00%	22,178,696	9.18%

Note 19 - Employee and Director Benefit Plans

The Company has a 401(k) Profit Sharing Plan (the Plan) for the benefit of its employees. The expense for contributions to the Plan was \$38,473 in 2009 and \$80,816 in 2008. No Company matching contributions were made in 2009. The expense in 2009 was the result of a valuation write-down of company stock held to fund employee purchases of company stock through their ordinary semi-monthly payroll plan contributions. For 2008, matching contributions were 50% of the amounts deferred by employees, up to 2.5% of pay. In 2008 the profit sharing contribution was 0.0% of eligible pay.

The Company established a retirement benefit for directors in 2004. Benefits were to be based upon length of service. The timing of benefits was based upon the age of the director. In December 2009, the directors voluntarily terminated their retirement agreements with the Company, thereby providing an increase to capital of \$148,164. As compensation for terminating their agreements, each director will be paid \$100 in December 2010. Listed below are the costs of the benefits for the years ended December 31:

	<u>2009</u>	<u>2008</u>
Beginning balance	\$ 148,864	\$ 109,720
Expense	(148,164)	39,144
Ending balance	<u>\$ 700</u>	<u>\$ 148,864</u>

Note 20 - Stock Options and Restricted Stock

The Company has two stock-based compensation plans (the Plans). Both Plans allow the granting of qualified and nonqualified stock options, while only the 2004 Incentive Stock Plan allows shares of restricted stock to be granted. Current options granted under the Plans include incentive stock options as well as nonqualified options. The Company receives a tax benefit for nonqualified stock options that are exercised. For tax purposes, the Company is allowed to deduct the difference between the market price and option price of the options exercised. Options are granted at exercise prices equal to the market value on the grant date and expire 10 years from the date of grant. The vesting of the stock options varies according to individualized agreements. Vesting periods range up to five years. The compensation cost recorded for these Plans was \$65,571 for 2009 and \$92,600 for 2008. No options were exercised in 2009. The income tax benefit related to the exercise of stock options in 2008 was \$8,325.

The 2004 Incentive Stock Plan (the Plan) was approved by shareholders in December 2004. This Plan allows up to 200,000 shares of stock options to be awarded to employees and up to 40,000 shares of restricted stock to be granted to employees and directors. Outstanding options under the 2004 Incentive Stock Plan, when combined with outstanding options under the 1998 Stock Option Plan, are limited to 15% of the outstanding common shares of the Company. As of December 31, 2009,

IDAHO BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

Note 20 - Stock Options and Restricted Stock – continued

there were 53,200 options and 5,307 shares of restricted stock outstanding, with 146,800 options and 31,155 shares of restricted stock available for future grants.

The Company's 1998 Stock Option Plan, as amended by shareholders at the 2003 Annual Meeting, authorizes 430,000 shares of stock to be granted to employees and directors. At December 31, 2009, there were 77,120 option shares outstanding and 27,136 option shares available for future grant.

Stock option activity for both Plans is summarized in the following table for years ended December 31:

	<u>2009</u>		<u>2008</u>	
	<u>Number of Options</u>	<u>Weighted Average Exercise Price</u>	<u>Number of Options</u>	<u>Weighted Average Exercise Price</u>
Outstanding at beginning of year:	146,060	\$ 11.25	163,500	\$ 11.35
Options granted	-	-	36,000	10.43
Options exercised	-	-	(24,340)	8.54
Options forfeited	(15,740)	11.16	(29,100)	13.04
Outstanding at end of year	<u>130,320</u>	11.26	<u>146,060</u>	11.25

Further information on stock options as of December 31, 2009 follows:

	<u>Outstanding</u>	<u>Vested</u>	<u>Unvested</u>
Number of options	130,320	89,540	40,780
Weighted average exercise price	\$ 11.26	\$ 10.78	\$ 12.32
Weighted average remaining contractual life - years	5.0	3.7	7.7
Aggregate intrinsic value assuming price of \$1.90	\$ -	\$ -	\$ -

Stock option compensation cost is calculated using the Black-Scholes option valuation model. The Black-Scholes model uses the option's exercise price, the estimated life of the option, the risk-free rate for that life, future dividend payments, and the volatility of the Company's stock prices on NASDAQ's Over-the-Counter Bulletin Board. The assumptions and values used in the valuation model are listed below. The following is information on options granted during the years ended December 31:

	<u>2009</u>	<u>2008</u>
Option shares granted	-	36,000
Estimated life - years	N/A	5
Weighted average risk-free rate	N/A	2.95%
Assumed future dividend payments	N/A	N/A
Assumed volatility	N/A	28.12%
Weighted average exercise price	N/A	\$ 10.43
Weighted average fair value at grant	N/A	2.77
Aggregate compensation cost of options granted	-	99,634

IDAHO BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

Note 20 - Stock Options and Restricted Stock – continued

The following is information on the exercise of options during the years ended December 31:

	<u>2009</u>	<u>2008</u>
Option shares exercised	-	24,340
Fair value of shares exercised	\$ -	\$ 229,234
Proceeds from the exercise of options	-	207,873
Intrinsic value of options exercised	<u>\$ -</u>	<u>\$ 21,361</u>

The compensation cost of options is recognized on a straight-line method over the vesting period of the option. The Company had unrecognized compensation costs of \$134,978 and \$197,491 as of December 31, 2009 and 2008, respectively. These costs will be recognized over future weighted average periods of 2.27 and 3.25 years, respectively.

Information regarding unvested stock options and their weighted average fair value, at the date of grant, is shown below for the years ended December 31:

	<u>2009</u>		<u>2008</u>	
	Unvested Options	Weighted Average Fair Value at Grant	Unvested Options	Weighted Average Fair Value at Grant
Unvested options at beginning of year	59,020	\$ 3.35	50,320	\$ 2.75
Options granted	-	-	36,000	2.77
Options vested	(17,640)	3.46	(26,140)	2.22
Options forfeited	<u>(600)</u>	<u>(2.83)</u>	<u>(1,160)</u>	15.21
Unvested options at end of year	<u>40,780</u>	3.31	<u>59,020</u>	3.35

The total fair value of shares vested was \$258,878 and \$241,852 for the years ended December 31, 2009 and 2008, respectively.

The 2004 Plan permits the Company to grant restricted stock to its directors and employees. Listed below is a summary of the restricted stock activity for the years ended December 31:

	<u>2009</u>		<u>2008</u>	
	Unvested Options	Weighted Average Fair Value at Grant	Unvested Options	Weighted Average Fair Value at Grant
Unvested shares at beginning of year	7,076	\$ 16.25	9,195	\$ 16.25
Stock granted	-	-	-	-
Stock vested	(1,734)	16.25	(1,769)	16.25
Stock forfeited	<u>(35)</u>	16.25	<u>(350)</u>	16.25
Unvested shares at end of year	<u>5,307</u>	16.25	<u>7,076</u>	16.25

The total fair value of restricted stock grants was \$10,083 for the year ended December 31, 2009.

IDAHO BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

Note 21 - Fair Value of Financial Instruments

ASC No. 820-10 defines fair value, establishes a consistent framework for measuring fair value and expands disclosure requirements about fair value measurements. ASC No. 820-10, among other things, requires the Company to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions. These two types of inputs create the following fair value hierarchy:

- Level 1 – Quoted prices for identical instruments in active markets
- Level 2 – Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable.
- Level 3 – Instruments whose significant value drivers are unobservable.

The Company holds fixed and variable rate interest bearing securities and certain other financial instruments, which are carried at fair value. Fair value is determined based upon quoted prices when available or through the use of alternative approaches, such as matrix or model pricing, when market quotes are not readily accessible or available.

	December 31, 2009			
	<u>Carrying Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Recurring Items				
Available-for-sale securities	\$ 34,469,224	\$ -	\$ 34,469,224	\$ -
Non-Recurring Items				
Impaired loans	24,571,691	-	-	24,571,691
Retaken real estate owned	2,538,124	-	-	2,538,124
Total	<u>\$ 61,579,039</u>	<u>\$ -</u>	<u>\$ 34,469,224</u>	<u>\$ 27,109,815</u>

	December 31, 2008			
	<u>Carrying Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Recurring Items				
Available-for-sale securities	\$ 25,561,299	\$ -	\$ 25,561,299	\$ -
Non-Recurring Items				
Impaired loans	10,907,308	-	-	10,907,308
Retaken real estate owned	380,099	-	-	380,099
Total	<u>\$ 36,848,706</u>	<u>\$ -</u>	<u>\$ 25,561,299</u>	<u>\$ 11,287,407</u>

Fair values are determined as follows:

- Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. Level 2 securities include certain collateralized mortgage and debt obligations. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy.

IDAHO BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

Note 21 - Fair Value of Financial Instruments – continued

• Where valuations have been determined by independent appraisers for properties associated with either impaired loans or retaken real estate, the Bank adjusts the value of these assets to the lower of cost or market, based on the appraisers' valuations. Under ASC 820-10 guidelines, these assets are then classified as Level 3. Where valuations are determined by management based on market knowledge and experience, asset valuation is considered to be Level 3. Assets may be moved from Level 3 to Level 2 as more observable valuations are performed.

The following represent the book value and estimated fair value of financial instruments as of December 31:

	2009		2008	
	Book Value	Estimated Fair Value	Book Value	Estimated Fair Value
Financial assets				
Cash and due from banks	\$ 4,759,746	\$ 4,759,746	\$ 2,584,019	\$ 2,584,019
Interest-bearing deposits with banks	26,485	26,485	105,150	107,151
Federal funds sold	165,950	165,950	114,698	114,698
Available-for-sale securities	34,469,224	34,469,224	25,561,299	25,561,299
Equity securities	2,273,875	2,272,035	2,180,925	2,243,560
Loans held for sale less unearned fees	2,380,699	2,380,699	4,596,327	4,596,327
Loans , net of allowance and unearned fees	173,301,933	173,682,738	201,092,064	201,866,008
Cash value of bank-owned life insurance	2,279,443	2,279,443	2,203,763	2,203,763
Accrued interest receivable	782,153	782,153	893,887	893,887
Financial liabilities				
Demand and savings deposits	\$ 78,150,755	\$ 78,150,755	\$ 80,707,026	\$ 80,707,026
Time deposits	115,758,152	116,983,575	104,603,214	106,573,901
Federal funds purchased and securities sold under agreements to repurchase	608,141	608,141	21,111,768	21,111,768
Subordinated debentures	7,217,000	7,654,581	7,217,000	7,871,046
Other borrowings	15,000,000	15,438,903	17,350,000	17,943,380
Accrued interest payable	514,357	514,357	594,588	594,588

Estimated fair values require subjective judgments and are not necessarily representative of amounts that could be realized in actual market transactions, or of the underlying value of the Company. The value of depositor relationships (core deposit intangibles) is not reflected. Changes in the following methodologies and assumptions could significantly affect the estimates.

Financial assets:

The estimated fair value of cash and due from banks and federal funds sold approximates book value. The estimated fair value of interest-bearing time deposits with banks is estimated by discounting future cash flows using current interest rates. For debt securities, the fair value is based on quoted market prices at year end. Equity securities of the Federal Reserve Bank and Federal Home Loan Bank of Seattle are valued at cost. Other equity securities are valued at market value. The fair value of fixed-rate loans is estimated by discounting future cash flows using current rates at which loans with similar terms and credit quality would be made. For variable-rate loans that reprice frequently and have no significant change in credit risk, fair value approximates book value.

Financial liabilities:

The estimated fair value of demand and savings deposits approximates book value. The fair value of time certificates of deposit is estimated by discounting future cash flows using current rates. For Federal funds purchased and securities sold under agreements to repurchase, the fair value approximates book value. For subordinate debentures and other borrowings the fair value of fixed-rate borrowings is estimated by discounting future cash flows using current rates offered on similar borrowings.

IDAHO BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

Note 21 - Fair Value of Financial Instruments – continued

Off-balance sheet financial instruments:

Loan commitments to extend credit and letters of credit are off-balance sheet financial instruments. The fair value of those instruments approximates the notational value.