

GREAT SOUTHERN BANCORP INC
Form 10-K
March 24, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2009

Commission File Number 0-18082

GREAT SOUTHERN BANCORP, INC.
(Exact name of registrant as specified in its charter)

Maryland
(State of Incorporation)

43-1524856
(IRS Employer Identification Number)

1451 E. Battlefield, Springfield, Missouri
(Address of Principal Executive Offices)

65804
(Zip Code)

(417) 887-4400
Registrant's telephone number, including area code

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value \$0.01 per share	The NASDAQ Stock Market LLC

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

Indicate by check mark if the Registrant is a well-known seasoned issuer,
as defined in Rule 405 of the Securities Act.

Yes [] No [X]

Indicate by check mark if the Registrant is not required to file reports
pursuant to Section 13 or Section 15(d) of the Act.

Yes [] No [X]

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
the Registrant was required to file such reports), and (2) has been subject
to such filing requirements for the past 90 days.

Yes [X] No []

Indicate by check mark whether the registrant has submitted
electronically and posted on its corporate Web site, if any, every
Interactive Data File required to be submitted and posted pursuant to Rule
405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12

Yes [X] No []

months (or for such shorter period that the registrant was required to submit and post such files).

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of 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 definitions of "accelerated filer," "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

(Check one):

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

Indicated by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes No

The aggregate market value of the common stock of the Registrant held by non-affiliates of the Registrant on June 30, 2009, computed by reference to the closing price of such shares on that date, was \$206,701,106. At March 22, 2010, 13,425,250 shares of the Registrant's common stock were outstanding.

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PART I

ITEM 1. BUSINESS.

THE COMPANY

Great Southern Bancorp, Inc.

Great Southern Bancorp, Inc. ("Bancorp" or "Company") is a bank holding company and a financial holding company and parent of Great Southern Bank ("Great Southern" or the "Bank"). Bancorp was incorporated under the laws of the State of Delaware in July 1989 as a unitary savings and loan holding company. After receiving the approval of the Federal Reserve Bank of St. Louis (the "Federal Reserve Board" or "FRB"), the Company became a one-bank holding company on June 30, 1998, upon the conversion of Great Southern to a Missouri-chartered trust company. In 2004, Bancorp was re-incorporated under the laws of the State of Maryland.

As a Maryland corporation, the Company is authorized to engage in any activity that is permitted by the Maryland General Corporation Law and is not prohibited by law or regulatory policy. The Company currently conducts its business as a financial holding company. Through the financial holding company structure, it is possible to expand the size and scope of the financial services offered by the Company beyond those offered by the Bank. The financial holding company structure provides the Company with greater flexibility than the Bank has to diversify its business activities, through existing or newly formed subsidiaries, or through acquisitions or mergers of other financial institutions as well as other companies. At December 31, 2009, Bancorp's consolidated assets were \$3.64 billion, consolidated net loans were \$2.08 billion, consolidated deposits were \$2.71 billion and consolidated total stockholders' equity was \$299 million. The assets of the Company consist primarily of the stock of Great Southern, available-for-sale securities, minority interests in a local trust company and a merchant banking company and cash.

Through the Bank and subsidiaries of the Bank, the Company offers insurance, travel, investment and related services, which are discussed further below. The activities of the Company are funded by retained earnings and through dividends from Great Southern. Activities of the Company may also be funded through borrowings from third parties, sales of additional securities or through income generated by other activities of the Company. The Company expects to finance its future activities in a similar manner.

The executive offices of the Company are located at 1451 East Battlefield, Springfield, Missouri 65804, and its telephone number at that address is (417) 887-4400.

Great Southern Bank

Great Southern was formed as a Missouri-chartered mutual savings and loan association in 1923, and, in 1989, converted to a Missouri-chartered stock savings and loan association. In 1994, Great Southern changed to a federal savings bank charter and then, on June 30, 1998, changed to a Missouri-chartered trust company (the equivalent of a commercial bank charter). Headquartered in Springfield, Missouri, Great Southern offers a broad range of banking services through its 72 banking centers located in southwestern and central Missouri, the Kansas City, Missouri area, the St. Louis, Missouri area, eastern Kansas, eastern Nebraska and western and central Iowa. At December 31, 2009, the Bank had total assets of \$3.64 billion, net loans of \$2.08 billion, deposits of \$2.76 billion and stockholders' equity of \$285 million, or 7.8% of total assets. Its deposits are insured by the Deposit Insurance Fund ("DIF") to the maximum levels permitted by the Federal Deposit Insurance Corporation ("FDIC").

Great Southern is principally engaged in the business of originating residential and commercial real estate loans, construction loans, other commercial loans and consumer loans and funding these loans through attracting deposits

from the general public, originating brokered deposits and borrowings from the Federal Home Loan Bank of Des Moines (the "FHLBank") and others.

For many years, Great Southern has followed a strategy of emphasizing quality loan origination through residential, commercial and consumer lending activities in its market areas. The goal of this strategy has been to maintain its position as one of the leading providers of financial services in its market area, while simultaneously

diversifying assets and reducing interest rate risk by originating and holding adjustable-rate loans in its portfolio and selling fixed-rate single-family mortgage loans in the secondary market. The Bank continues to place primary emphasis on residential mortgage and other real estate lending while also expanding and increasing its originations of commercial business and consumer loans.

The corporate office of the Bank is located at 1451 East Battlefield, Springfield, Missouri 65804 and its telephone number at that address is (417) 887-4400.

Forward-Looking Statements

When used in this Form 10-K and in future filings by the Company with the Securities and Exchange Commission (the "SEC"), in the Company's press releases or other public or shareholder communications, and in oral statements made with the approval of an authorized executive officer, the words or phrases "will likely result" "are expected to," "will continue," "is anticipated," "estimate," "project," "intends" or similar expressions are intended to identify "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are subject to certain risks and uncertainties, including, among other things, (i) expected cost savings, synergies and other benefits from the Company's merger and acquisition activities might not be realized within the anticipated time frames or at all, and costs or difficulties relating to integration matters, including but not limited to customer and employee retention, might be greater than expected; (ii) changes in economic conditions, either nationally or in the Company's market areas; (iii) fluctuations in interest rates; (iv) the risks of lending and investing activities, including changes in the level and direction of loan delinquencies and write-offs and changes in estimates of the adequacy of the allowance for loan losses; (v) the possibility of other-than-temporary impairments of securities held in the Company's securities portfolio; (vi) the Company's ability to access cost-effective funding; (vii) fluctuations in real estate values and both residential and commercial real estate market conditions; (viii) demand for loans and deposits in the Company's market areas; (ix) legislative or regulatory changes that adversely affect the Company's business; (x) monetary and fiscal policies of the Federal Reserve Board and the U.S. Government and other governmental initiatives affecting the financial services industry; (xi) results of examinations of the Company and Great Southern by their regulators, including the possibility that the regulators may, among other things, require the Company to increase its allowance for loan losses or to write-down assets; (xii) the uncertainties arising from the Company's participation in the TARP Capital Purchase Program, including impacts on employee recruitment and retention and other business and practices, and uncertainties concerning the potential redemption by us of the U.S. Treasury's preferred stock investment under the program, including the timing of, regulatory approvals for, and conditions placed upon, any such redemption; (xiii) costs and effects of litigation, including settlements and judgments; and (xiv) competition. The Company wishes to advise readers that the factors listed above could affect the Company's financial performance and could cause the Company's actual results for future periods to differ materially from any opinions or statements expressed with respect to future periods in any current statements.

The Company does not undertake-and specifically declines any obligation- to publicly release the result of any revisions which may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

Internet Website

Bancorp maintains a website at www.greatsouthernbank.com. The information contained on that website is not included as part of, or incorporated by reference into, this Annual Report on Form 10-K. Bancorp currently makes available on or through its website Bancorp's Annual Report on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K or amendments to these reports. These materials are also available free of charge (other than a user's regular internet access charges) on the Securities and Exchange Commission's website at www.sec.gov.

Market Areas

Until 2009, Great Southern's primary market area encompassed 16 counties in southwestern, western and central Missouri. In 2009, the Company increased its banking center network from 39 to 72 full-service banking centers serving more than 148,000 customer households in four states. The Company accomplished this primarily

through two FDIC-assisted transactions which significantly expanded its geographic footprint and customer base in Iowa, Kansas and Nebraska. In addition to the FDIC-assisted transactions, two de novo banking centers were opened in 2009. The Company opened its first retail banking center in the St. Louis metropolitan area, complementing its loan production office and travel agency already serving this market area. A second banking center in Lee's Summit, Mo., a suburb of the Kansas City metropolitan area, was opened providing added convenience for customers in this market.

Great Southern's largest concentration of loans and deposits is in the Springfield, Mo., area. The Company's growth in 2009 provided greater diversification of its loan and deposit portfolios with additional concentrations in the Kansas City and St. Louis metropolitan markets, the Branson, Mo., area, and the Sioux City and Des Moines, Iowa, markets. Loans and deposits are also generated in banking centers in rural markets in Missouri, Iowa, Kansas and Nebraska. In addition, the Company operates a loan production office in Rogers, Ark., which serves the Northwest Arkansas region.

As of December 31, 2009, the Company's total loan portfolio balance, excluding loans covered by FDIC loss sharing agreements, was \$1.7 billion. Geographically, the loan portfolio consists of loans collateralized by property (real estate and other assets) located in the following regions (including loan balance and percentage of total loans): Springfield (\$511 million, 30%); St. Louis (\$238 million, 14%); Branson (\$205 million, 12%); Northwest Arkansas (\$150 million, 9%); Kansas City (\$103 million, 6%); other Missouri regions (\$138 million, 8%), and other states (\$363 million, 21%). The Company's balance of its portfolio of loans covered by FDIC loss sharing agreements was \$619 million as of December 31, 2009. The FDIC loss sharing agreements, which were a part of the two FDIC-assisted transactions completed in 2009, provide the Company significant protection against losses on the loans in this portfolio. Geographically, the total loan portfolio covered by FDIC loss sharing agreements consists of loans collateralized by pr(real estate and other assets) located in the following regions (including loan balance and percentage of total loans): Iowa (\$227 million, 37%); Kansas City (\$167 million, 27%); Kansas (\$32 million, 5%); other Missouri regions (\$34 million, 5%), and other regions (\$159 million, 26%).

According to the January 2010 Federal Reserve Beige Book, general market economic conditions continued to be challenging in the Company's geographic footprint. Loan demand remained weak with some continued credit quality deterioration in most of the markets. Home sales picked up somewhat with sales of lower-priced homes increasing proportionately more than sales of higher-priced homes, due at least in part to the first-time buyer federal tax credit. Commercial real estate markets remained relatively weak. Unemployment in each of Great Southern's market areas was below the national unemployment rate, except for the St. Louis metropolitan statistical area, which was slightly above the national rate.

Lending Activities

General

From its beginnings in 1923 through the early 1980s, Great Southern primarily made long-term, fixed-rate residential real estate loans that it retained in its loan portfolio. Beginning in the early 1980s, Great Southern increased its efforts to originate short-term and adjustable-rate loans. Beginning in the mid-1980s, Great Southern increased its efforts to originate commercial real estate and other residential loans, primarily with adjustable rates or shorter-term fixed rates. In addition, some competitor banking organizations merged with larger institutions and changed their business practices or moved operations away from the Springfield, Mo. area, and others consolidated operations from the Springfield, Mo. area to larger cities. This provided Great Southern expanded opportunities in residential and commercial real estate lending as well as in the origination of commercial business and consumer loans, primarily in indirect automobile lending.

In addition to origination of these loans, the Bank has expanded and enlarged its relationships with smaller banks to purchase participations (at par, generally with no servicing costs) in loans the smaller banks originate but are unable to retain in their portfolios due to capital limitations. The Bank uses the same underwriting guidelines in evaluating these participations as it does in its direct loan originations. At December 31, 2009, the balance of participation loans purchased and held in portfolio, excluding those covered by loss sharing agreements, was \$25.7 million, or 1.5% of the total loan portfolio. None of these participation loans were non-performing at December 31, 2009.

One of the principal historical lending activities of Great Southern is the origination of fixed and adjustable-rate conventional residential real estate loans to enable borrowers to purchase or refinance owner-occupied homes. Great Southern originates a variety of conventional, residential real estate mortgage loans, principally in compliance with Freddie Mac and Fannie Mae standards for resale in the secondary market. Great Southern promptly sells most of the fixed-rate residential mortgage loans that it originates. Depending on market conditions, the ongoing servicing of these loans is at times retained by Great Southern, but generally servicing is released to the purchaser of the loan. Great Southern retains substantially all of the adjustable-rate mortgage loans that it originates in its portfolio. To date, Great Southern has not experienced problems selling these loans in the secondary market.

Another principal lending activity of Great Southern is the origination of commercial real estate and commercial construction loans. Since the early 1990s, this area of lending has been an increasing percentage of the loan portfolio and accounted for approximately 38% of the combined portfolio, excluding those commercial real estate and commercial construction loans covered by loss sharing agreements, at December 31, 2009. For the portfolio of loans covered by loss sharing agreements, commercial real estate and commercial construction loans accounted for approximately 10% of the combined portfolio at December 31, 2009.

In addition, Great Southern in recent years has increased its emphasis on the origination of other commercial loans, home equity loans, consumer loans and student loans, and is also an issuer of letters of credit. Letters of credit are contingent obligations and are not included in the Bank's loan portfolio. See "-- Other Commercial Lending," "- Classified Assets," and "Loan Delinquencies and Defaults" below.

The percentage of collateral value Great Southern will loan on real estate and other property varies based on factors including, but not limited to, the type of property and its location and the borrower's credit history. As a general rule, Great Southern will loan up to 95% of the appraised value on single-family properties and up to 90% on two- to four-family residential property. Typically, private mortgage insurance is required for loan amounts above the 80% level. For commercial real estate and other residential real property loans, Great Southern may loan up to a maximum of 85% of the appraised value. The origination of loans secured by other property is considered and determined on an individual basis by management with the assistance of any industry guides and other information which may be available.

Loan applications are approved at various levels of authority, depending on the type, amount and loan-to-value ratio of the loan. Loan commitments of more than \$750,000 (or loans exceeding the Freddie Mac loan limit in the case of fixed-rate, one- to four-family residential loans for resale) must be approved by Great Southern's loan committee. The loan committee is comprised of the Chief Executive Officer of the Bank, as chairman of the committee, and other senior officers of the Bank involved in lending activities.

Although Great Southern is permitted under applicable regulations to originate or purchase loans and loan participations secured by real estate located in any part of the United States, the Bank has concentrated its lending efforts in Missouri and Northern Arkansas, with the largest concentration of its lending activity being in southwestern and central Missouri. As a result of the acquisitions in 2009, the Bank has significant lending activity in Iowa, Kansas and Nebraska, as well. In addition, the Bank has made loans, secured primarily by commercial real estate, in other states, primarily Oklahoma, Texas, Colorado and Minnesota.

Acquired Loans and Loss Sharing Agreements

TeamBank

On March 20, 2009, Great Southern Bank entered into a purchase and assumption agreement with loss share with the Federal Deposit Insurance Corporation (FDIC) to assume all of the deposits (excluding brokered deposits) and acquire certain assets of TeamBank, N.A., a full service commercial bank headquartered in Paola, Kansas.

The loans, commitments and foreclosed assets purchased in the TeamBank transaction are covered by a loss sharing agreement between the FDIC and Great Southern Bank which affords the Bank significant protection. Under the loss sharing agreement, the Bank will share in the losses on assets covered under the agreement (referred to as covered assets). On losses up to \$115.0 million, the FDIC has agreed to reimburse the Bank for 80% of the losses. On losses exceeding \$115.0 million, the FDIC has agreed to reimburse the Bank for 95% of the losses. Realized losses covered by the loss sharing agreement include loan contractual balances (and related unfunded commitments that were acquired), accrued interest on loans for up to 90 days, the book value of foreclosed real estate acquired, and certain direct costs, less cash or other consideration received by Great Southern. This agreement extends for ten years for 1-4 family real estate loans and for five years for other loans. The value of this loss sharing agreement was considered in determining fair values of loans and foreclosed assets acquired. The loss sharing agreement is subject to the Bank following servicing procedures as specified in the agreement with the FDIC. The expected reimbursements under the loss sharing agreement were recorded as an indemnification asset at their preliminary estimated fair value on the acquisition date.

The Bank recorded a preliminary one-time gain of \$27.8 million (pre-tax) based upon the initial estimated fair value of the assets acquired and liabilities assumed in accordance with FASB ASC 805 (SFAS No. 141 (R), Business Combinations). FASB ASC 805 allows a measurement period of up to one year to adjust initial fair value estimates as of the acquisition date. Subsequent to the initial fair value estimate calculations in the first quarter of 2009, additional information was obtained about the fair value of assets acquired and liabilities assumed as of March 20, 2009, which resulted in adjustments to the initial fair value estimates. Most significantly, additional information was obtained on the credit quality of certain loans as of the acquisition date which resulted in increased fair value estimates of the acquired loan pools. The fair values of these loan pools were adjusted and the provisional fair values finalized. These adjustments resulted in a \$16.1 million increase to the initial one-time gain of \$27.8 million. Thus, the final gain was \$43.9 million related to the fair value of the acquired assets and assumed liabilities. This gain was included in Non-Interest Income in the Company's Consolidated Statement of Operations for the year ended December 31, 2009.

The Bank originally recorded the fair value of the acquired loans at their preliminary fair value of \$222.8 million and the related FDIC indemnification asset was originally recorded at its preliminary fair value of \$153.6 million. As discussed above, these initial fair values were adjusted during the measurement period, resulting in a final fair value at the acquisition date of \$264.4 million for acquired loans and \$128.3 million for the FDIC indemnification asset. A discount was recorded in conjunction with the fair value of the acquired loans and the amount accreted to yield during 2009 since acquisition was \$966,000. No reclassifications were made in 2009 from nonaccretable discount to accretable discount.

In addition to the loan and FDIC indemnification assets noted above, the acquisition consisted of assets with a fair value of approximately \$628.2 million, including \$111.8 million of investment securities, \$83.4 million of cash and cash equivalents, \$2.9 million of foreclosed assets and \$3.9 million of FHLB stock. Liabilities with a fair value of \$610.2 million were also assumed, including \$515.7 million of deposits, \$80.9 million of FHLB advances and \$2.3 million of repurchase agreements with a commercial bank. A customer-related core deposit intangible asset of \$2.9 million was also recorded. In addition to the excess of liabilities over assets, the Bank received approximately \$42.4 million in cash from the FDIC and entered into a loss sharing agreement with the FDIC.

Vantus Bank

On September 4, 2009, Great Southern Bank entered into a purchase and assumption agreement with loss share with the FDIC to assume all of the deposits and acquire certain assets of Vantus Bank, a full service thrift headquartered in Sioux City, Iowa.

The loans, commitments and foreclosed assets purchased in the Vantus Bank transaction are covered by a loss sharing agreement between the FDIC and Great Southern Bank which affords the Bank significant protection. Under the loss sharing agreement, the Bank will share in the losses on assets covered under the agreement (referred to as covered assets). On losses up to \$102.0 million, the FDIC has agreed to reimburse the Bank for 80% of the losses. On losses exceeding \$102.0 million, the FDIC has agreed to reimburse the Bank for 95% of the losses. Realized losses covered by the loss sharing agreement include loan contractual balances (and related unfunded commitments that were acquired), accrued interest on loans for up to 90 days, the book value of foreclosed real estate acquired, and certain direct costs, less cash or other consideration received by Great Southern. This agreement extends for ten years for 1-4 family real estate loans and for five years for other loans. The value of this loss sharing agreement was considered in determining fair values of loans and foreclosed assets acquired. The loss sharing agreement is subject to the Bank following servicing procedures as specified in the agreement with the FDIC. The expected reimbursements under the loss sharing agreement were recorded as an indemnification asset at their preliminary estimated fair value of \$62.2 million on the acquisition date. Based upon the acquisition date fair values of the net assets acquired, no goodwill was recorded. The transaction resulted in an initial preliminary gain of \$45.9 million, which was included in Non-Interest Income in the Company's Consolidated Statement of Operations for the year ended December 31, 2009. The Company continues to analyze its estimates of the fair values of the loans acquired and the indemnification asset recorded. The Company has not yet finalized its analysis of these assets and, therefore, adjustments to the recorded carrying values may occur.

The acquisition consisted of assets with a fair value of approximately \$294.2 million, including \$247.0 million of loans, \$23.1 million of investment securities, \$12.8 million of cash and cash equivalents, \$2.2 million of foreclosed assets and \$5.9 million of FHLB stock. Liabilities with a fair value of \$444.0 million were also assumed, including \$352.7 million of deposits, \$74.6 million of FHLB advances, \$10.0 million of borrowings from the Federal Reserve Bank and \$3.2 million of repurchase agreements with a commercial bank. A customer-related core deposit intangible asset of \$2.2 million was also recorded. In addition to the excess of liabilities over assets, the Bank received approximately \$131.3 million in cash from the FDIC and entered into a loss sharing agreement with the FDIC.

At the time of these acquisitions, the Company determined the fair value of the loan portfolios based on several assumptions. Factors considered in the valuations were projected cash flows for the loans, type of loan and related collateral, classification status, fixed or variable interest rate, term of loan, current discount rates and whether or not the loan was amortizing. Loans were grouped together according to similar characteristics and were treated in the aggregate when applying various valuation techniques. Management also estimated the amount of credit losses that were expected to be realized for the loan portfolios. The discounted cash flow approach was used to value each pool of loans. For non-performing loans, fair value was estimated by calculating the present value of the recoverable cash flows using a discount rate based on comparable corporate bond rates. This valuation of the acquired loans is a significant component leading to the valuation of the loss sharing assets recorded.

The loss sharing asset is measured separately from the loan portfolio because it is not contractually embedded in the loans and is not transferable with the loans should the Bank choose to dispose of them. Fair value was estimated using projected cash flows available for loss sharing based on the credit adjustments estimated for each loan pool (as discussed above) and the loss sharing percentages outlined in the Purchase and Assumption Agreement with the FDIC. These cash flows were discounted to reflect the uncertainty of the timing and receipt of the loss sharing reimbursement from the FDIC. The loss sharing asset is also separately measured from the related foreclosed real estate.

Method of Accounting for Loans Acquired in a Business Combination

FASB ASC 310-30 (AICPA Statement of Position 03-3, Accounting for Certain Loans or Debt Securities Acquired in a Transfer), applies to a loan with evidence of deterioration of credit quality since origination, acquired by completion of a transfer for which it is probable, at acquisition, that the investor will be unable to collect all contractually required payments receivable. ASC 310-30 must be applied to all loans which meet its specific criteria and prohibits carrying over or creating an allowance for loan losses upon initial recognition.

For loans acquired through a business combination that do not meet the specific criteria of ASC 310-30, there is an issue as to the method of recognition of the discount accretion for these loans receivable that:

were acquired in a business combination or asset purchase;
resulted in recognition of a discount attributable, at least in part, to credit quality; and
were not subsequently accounted for at fair value.

The discount relating to such acquired loans must be accounted for subsequently through accretion. One accounting policy method of recognizing this discount accretion is based on the acquired loans' contractual cash flow, as described in the guidance for accounting for loan origination fees and costs that is included in FASB ASC 310-20 (FASB Statement No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases). This method would accrete to income the entire discount recorded on the acquired loans over the life of the loans, regardless of whether the discount is attributable, at least in part, to credit quality.

A second accounting policy method of recognizing this discount accretion is based on the acquired loans' expected cash flow, as described in the guidance for accounting for loans acquired in a transfer that have deteriorated in credit quality since origination that is included in FASB ASC 310-30. Applying the guidance in FASB 310-30 for interest income would result in recognition of the difference between the initial recorded investment and the loans' expected principal and interest cash flows using the interest method. This application would not accrete to income the portion of the discount that is attributable to credit quality. The Company has used this accounting method to account for loans acquired through a business combination that do not meet the specific criteria of ASC 310-30.

It is our understanding that representatives from the AICPA and the Accounting Standards Executive Committee have reviewed this practice issue with representatives of the Securities and Exchange Commission (SEC) to determine the appropriate accounting method(s). It is our further understanding that, in the absence of further standard setting, for acquired loans that do not meet the specific criteria of FASB ASC 310-30 the SEC would not object to an accounting policy based on contractual cash flows or an accounting policy based on expected cash flows, as long as that policy is applied consistently.