UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2007

¨ **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT**
For the transition period from ______ to ______

COMMISSION FILE NO. 0000-50313

SURREY BANCORP

(Exact name of small business issuer as specified in its charter)

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

145 North Renfro Street, Mount Airy, NC 27030

(Address of principal executive offices)

(336) 783-3900

(Issuer s telephone number)

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

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

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer x

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

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

On August 3, 2007 there were 3,159,314 common shares issued and outstanding

Transitional Small Business Disclosure Format (Check One): Yes ¨ No x

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PART I FINANCIAL INFORMATION

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Consolidated Balance Sheets

June 30, 2007 (Unaudited) and December 31, 2006 (Audited)

	June 2007	December 2006
Assets		
Cash and due from banks	$ 1,490,952	$ 1,830,516
Interest-bearing deposits with banks	21,594,421	16,618,978
Federal funds sold	412,000	409,000
Investment securities available for sale	3,604,115	3,648,745
Restricted equity securities	926,364	1,051,230
Loans, net of allowance for loan losses of $2,564,921 in 2007 and $2,531,305 in 2006	156,152,095	153,852,006
Property and equipment, net	4,575,232	4,443,257
Foreclosed assets	115,564	77,503
Accrued income	1,126,922	1,047,143
Goodwill	120,000	120,000
Bank owned life insurance	2,898,892	2,847,137
Other assets	1,639,124	1,164,013
Total assets	$ 194,655,681	$ 187,109,528
Liabilities and Stockholders Equity		
Liabilities		
Deposits:		
Noninterest-bearing	$ 27,671,487	$ 24,339,102
Interest-bearing	128,692,680	126,752,168
Total deposits	156,364,167	151,091,270
Federal funds purchased and securities sold under agreements to repurchase	752,887	509,795
Other borrowings	13,734,798	14,163,487
Dividends payable on preferred stock	29,742	30,069
Accrued interest payable	675,139	604,893
Other liabilities	915,209	682,560
Total liabilities	172,471,942	167,082,074
Commitments and contingencies		
Stockholders equity		
Preferred stock, 1,000,000 shares authorized, 189,356 shares of Series A, issued and outstanding with no par value, 4.5% convertible non-cumulative, perpetual; with a liquidation value of $14 per share	2,620,325	2,620,325
Common stock, 5,000,000 shares authorized at no par value; 3,159,314 shares issued in 2007 and 3,002,168 shares issued in 2006	9,200,249	8,461,247
Retained earnings	10,366,927	8,950,342
Accumulated other comprehensive income (loss)	(3,762)	(4,460)
Total stockholders equity	22,183,739	20,027,454
Total liabilities and stockholders equity	$ 194,655,681	$ 187,109,528

See Notes to Consolidated Financial Statements

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Consolidated Statements of Income

Six months ended June 30, 2007 and 2006 (Unaudited)

	2007	2006
Interest income		
Loans and fees on loans	$ 6,834,551	$ 5,952,354
Federal funds sold	10,612	9,288
Investment securities, taxable	99,929	94,987
Deposits with banks	481,103	324,795
Total interest income	7,426,195	6,381,424
Interest expense		
Deposits	2,818,253	2,027,273
Federal funds purchased and securities sold under agreements to repurchase	9,168	16,688
Other borrowings	317,804	320,759
Total interest expense	3,145,225	2,364,720
Net interest income	4,280,970	4,016,704
Provision for loan losses	232,124	281,463
Net interest income after provision for loan losses	4,048,846	3,735,241
Noninterest income		
Service charges on deposit accounts	532,736	510,198
Gain on sale of government guaranteed loans	147,840	27,588
Fees and yield spread premiums on loans delivered to correspondents	113,263	109,754
Other service charges and fees	155,542	93,361
Other operating income	339,245	297,238
Total noninterest income	1,288,626	1,038,139
Noninterest expense		
Salaries and employee benefits	1,514,767	1,370,747
Occupancy expense	190,779	183,834
Equipment expense	162,170	167,079
Data processing	184,899	163,632
Foreclosed assets, net	21,282	749
Other expense	1,010,115	855,937
Total noninterest expense	3,084,012	2,741,978
Net income before income taxes	2,253,460	2,031,402
Income tax expense	777,718	741,735
Net income	1,475,742	1,289,667
Preferred stock dividends declared	(59,157)	(59,157)

Net income available to common shareholders	$ 1,416,585	$ 1,230,510
Basic earnings per share	$ 0.46	$ 0.42
Diluted earnings per share	$ 0.42	$ 0.37
Basic weighted average shares outstanding	3,091,884	2,945,054
Diluted weighted average shares outstanding	3,533,935	3,506,614

See Notes to Consolidated Financial Statements

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Consolidated Statements of Income

Three months ended June 30, 2007 and 2006 (Unaudited)

	2007	2006
Interest income		
Loans and fees on loans	$ 3,425,255	$ 3,049,482
Federal funds sold	5,320	4,898
Investment securities, taxable	48,024	52,471
Deposits with banks	271,992	147,579
Total interest income	3,750,591	3,254,430
Interest expense		
Deposits	1,423,177	1,043,502
Federal funds purchased and securities sold under agreements to repurchase	3,503	9,257
Other borrowings	159,322	168,224
Total interest expense	1,586,002	1,220,983
Net interest income	2,164,589	2,033,447
Provision for loan losses	116,024	198,624
Net interest income after provision for loan losses	2,048,565	1,834,823
Noninterest income		
Service charges on deposit accounts	275,716	266,963
Fees and yield spread premiums on loans delivered to correspondents	51,761	64,858
Other service charges and fees	89,585	47,361
Other operating income	175,377	134,749
Total noninterest income	592,439	513,931
Noninterest expense		
Salaries and employee benefits	753,984	675,171
Occupancy expense	91,043	90,583
Equipment expense	87,580	87,270
Data processing	94,953	90,074
Foreclosed assets, net	9,839	2,674
Other expense	476,733	459,742
Total noninterest expense	1,514,132	1,405,514
Net income before income taxes	1,126,872	943,240
Income tax expense	401,834	343,096
Net income	725,038	600,144
Preferred stock dividends declared	(29,742)	(29,743)

Net income available to common shareholders	$ 695,296	$ 570,401
Basic earnings per share	$ 0.22	$ 0.20
Diluted earnings per share	$ 0.20	$ 0.17
Basic weighted average shares outstanding	3,122,279	2,945,930
Diluted weighted average shares outstanding	3,565,078	3,506,844

See Notes to Consolidated Financial Statements

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Consolidated Statements of Cash Flows

Six months ended June 30, 2007 and 2006 (Unaudited)

	2007	2006
Cash flows from operating activities		
Net income	$ 1,475,742	$ 1,289,667
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation and amortization	154,372	166,416
Loss (gain) on the sale of foreclosed assets	21,282	749
Stock-based compensation	2,574	3,977
Provision for loan losses	232,124	281,463
Deferred income taxes	(61,382)	(21,123)
Accretion of discount on securities, net of amortization of premiums	(24,845)	(22,489)
Increase in cash surrender value of life insurance	(51,755)	(54,046)
Changes in assets and liabilities:		
Accrued income	(79,779)	(80,413)
Other assets	(414,165)	(740,704)
Accrued interest payable	70,246	68,589
Other liabilities	232,649	829,588
Net cash provided by operating activities	1,557,063	1,721,674
Cash flows from investing activities		
Net (increase) decrease in interest-bearing deposits with banks	(4,975,443)	2,221,617
Net (increase) decrease in federal funds sold	(3,000)	98,000
Purchases of investment securities	(2,467,382)	(2,480,272)
Sales and maturities of investment securities	2,537,991	3,014,518
Redemption of restricted equity securities	134,400	
Purchases of restricted equity securities	(9,534)	(44,100)
Net increase decrease in loans	(2,826,826)	(1,118,854)
Proceeds from the sale of foreclosed assets	235,270	193,286
Purchases of property and equipment	(286,347)	(70,206)
Net cash provided by (used in) investing activities	(7,660,871)	1,813,989
Cash flows from financing activities		
Net increase (decrease) in deposits	5,272,897	(4,239,009)
Net increase (decrease) in federal funds purchased and securities sold under agreements to repurchase	243,092	(563,926)
Net increase (decrease) in other borrowings	(428,689)	1,197,602
Dividends paid on preferred stock	(59,484)	(59,483)
Common stock options exercised	171,352	59,847
Fractional shares purchased		(19,641)
Tax benefit related to exercise of non-incentive stock options	565,076	12,330
Net cash provided by (used in) financing activities	5,764,244	(3,612,280)
Net decrease in cash and cash equivalents	(339,564)	(76,617)
Cash and cash equivalents, beginning	1,830,516	1,789,131
Cash and cash equivalents, ending	$ 1,490,952	$ 1,712,514

Supplemental disclosures of cash flow information

Interest paid	$ 3,074,979	$ 2,296,131
Taxes paid	$ 508,916	$ 735,690
Loans transferred to foreclosed properties	$ 294,613	$ 183,797

See Notes to Consolidated Financial Statements

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Consolidated Statements of Stockholders Equity

Six months ended June 30, 2007 and 2006 (Unaudited)

	Preferred Stock		Common Stock			Accumulated Other Comprehensive Income	
	Shares	Amount	Shares	Amount	Retained Earnings	(Loss)	Total
Balance, January 1, 2006	189,356	$ 2,620,325	1,472,094	$ 8,236,917	$ 6,418,744	$ (15,200)	$ 17,260,786
Comprehensive income							
Net income					1,289,667		1,289,667
Net change in unrealized gain (loss) on investment securities available for sale, net of income tax expense of $915						(1,459)	(1,459)
Total comprehensive income							1,288,208
Common stock issued							
Common stock options exercised			11,804	59,847			59,847
Tax benefit related to exercise of non-qualified stock options				12,330			12,330
Fractional shares purchased			(842)	(19,641)			(19,641)
Stock-based compensation				3,977			3,977
Dividends declared on convertible preferred stock ($.32 per share)					(59,157)		(59,157)
Balance, June 30, 2006	189,356	$ 2,620,325	1,483,056	$ 8,293,430	$ 7,649,254	$ (16,659)	$ 18,546,350
Balance, January 1, 2007	189,356	$ 2,620,325	3,002,168	$ 8,461,247	$ 8,950,342	$ (4,460)	$ 20,027,454
Comprehensive income							
Net income					1,475,742		1,475,742
Net change in unrealized gain (loss) on investment securities available for sale, net of income tax expense of $437						698	698
Total comprehensive income							1,476,440
Common stock issued							
Common stock options exercised, net of shares surrendered in cashless exchange			157,146	171,352			171,352
Tax benefit related to exercise of non-qualified stock options				565,076			565,076
Stock-based compensation				2,574			2,574
Dividends declared on convertible preferred stock ($.32 per share)					(59,157)		(59,157)
Balance, June 30, 2007	189,356	$ 2,620,325	3,159,314	$ 9,200,249	$ 10,366,927	$ (3,762)	$ 22,183,739

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SURREY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements were prepared in accordance with instructions for Form 10-Q and therefore, do not include all disclosures required by generally accepted accounting principles for a complete presentation of financial statements. In the opinion of management, the consolidated financial statements contain all adjustments necessary to present fairly the financial condition of Surrey Bancorp as of June 30, 2007, and December 31, 2006, the results of operations for the six and three months ended June 30, 2007 and 2006, and its changes in stockholders equity and cash flows for the six and three months ended June 30, 2007 and 2006. All adjustments are of a normal and recurring nature. The results of operations for the six months ended June 30, 2007, are not necessarily indicative of the results expected for the full year. These consolidated financial statements should be read in conjunction with the Company s audited financial statements and related disclosures for the year ended December 31, 2006, included in the Company s Form 10-KSB.

Organization

Surrey Bancorp (the Company) began operation on May 1, 2003, and was created for the purpose of acquiring all the outstanding shares of common stock of Surrey Bank & Trust. Shareholders of the bank received six shares of Surrey Bancorp common stock for every five shares of Surrey Bank & Trust common stock owned.

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

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

On July 31, 2000, Surrey Bank & Trust formed Friendly Finance, LLC, (Subsidiary) an operation specializing in the purchase of sales finance contracts from local automobile dealers. The Bank originally had a 60% majority interest in the company. On March 1, 2003, the Bank acquired the minority interest in Friendly Finance, LLC in exchange for the satisfaction of other commitments of the holder of the minority interest. On January 1, 2005, Friendly Finance, LLC s name was changed to Freedom Finance, LLC.

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

Critical Accounting Policies

The notes to our audited consolidated financial statements for the year ended December 31, 2006, contain a summary of our significant accounting policies. We believe our policies with respect to the methodology for our determination of the allowance for loan losses, and asset impairment judgments, including the recoverability of intangible assets involve a higher degree of complexity and require management to make difficult and subjective judgments with often require assumptions or estimates about highly uncertain matters. Changes in these judgments, assumptions or estimates could cause reported results to differ materially. These critical policies and their application are periodically reviewed with the Audit Committee and our Board of Directors. See our Annual Report for full details on critical accounting policies.

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Principles of Consolidation

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

Business Segments

The Company reports its activities in two business segments. In determining the appropriateness of segment definition, the Company considers the materiality of potential business segments and components of the business about which financial information is available, and regularly evaluated, relative to resource allocation and performance assessment.

Presentation of Cash Flows

For purposes of reporting cash flows, cash and cash equivalents includes cash and amounts due from depository institutions (including cash items in process of collection). Overnight interest bearing deposits and federal funds sold are shown separately. Cash flows from demand deposits, NOW accounts and savings accounts are reported net since their original maturities are less than three months. Loans and time deposits are reported net per FASB Statement No. 104. Federal funds purchased are shown separately.

Investment Securities

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

Investment securities classified as held to maturity are those debt securities that the Bank has the ability and intent to hold to maturity. Accordingly, these securities are carried at cost adjusted for amortization of premiums and accretion of discount, computed by the interest-method over their contractual lives. At June 30, 2007, and December 31, 2006, the Bank had no investments classified as held to maturity.

Loans Held for Sale

The Bank originates and holds SBA and USDA guaranteed loans in its portfolio in the normal course of business. During 2005, the Bank entered a program to sell the guaranteed portions of these loans into the secondary market. The loans are generally variable rate loans which eliminates the market risk to the Bank and are therefore carried at cost. The Bank recognizes gains on the sale of the guaranteed portion upon the consummation of the sale. The Bank plans to continue to originate guaranteed loans for sales, however no such loans were funded at June 30, 2007.

Loans Receivable

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

The allowance for loan losses is maintained at a level considered adequate to provide for losses that can be reasonably anticipated. The allowance is increased by provisions charged to operating expense and reduced by net charge-offs. The Bank makes continuous credit reviews of the loan portfolio and considers economic conditions, historical loan loss experience, review of specific problem loans and other factors in determining the adequacy of the allowance balance.

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Activity in the allowance for loan losses for the six months ended June 30, 2007 and 2006 follows:

	June 30, 2007	June 30, 2006
Balance at beginning of year	$ 2,531,305	$ 2,311,298
Add provision charged to expense	232,124	281,463
Less net charge-offs	(198,508)	(156,381)
	$ 2,564,921	$ 2,436,380

Interest on all loans is accrued daily on the outstanding balance. Accrual of interest is discontinued on a loan when management believes, after considering collection efforts and other factors, that the borrower s financial condition is such that collection of interest is doubtful.

NOTE 2. EARNINGS PER SHARE

Basic earnings per share for the six and three months ended June 30, 2007 and 2006, were calculated by dividing net income available to common shareholders by the weighted average number of shares outstanding during the period.

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

NOTE 3. BALANCE SHEETS

The balance sheet at December 31, 2006, has been taken from the audited financial statements at that date.

NOTE 4. COMMITMENTS AND LETTERS OF CREDIT

At June 30, 2007, the Company had commitments to extend credit, including unused lines of credit of approximately $33,664,000. Letters of credit totaling $1,266,037 were outstanding.

NOTE 5. STOCK BASED COMPENSATION

The Company accounts for stock-based compensation in accordance with, the Financial Accounting Standards Board s (FASB) SFAS No. 123 (revised 2004), *Share-Based Payment,* (SFAS No. 123R) which was issued by the FASB in December 2004. SFAS No. 123R revises SFAS No. 123, *Accounting for Stock Based Compensation*, and supersedes APB No. 25, *Accounting for Stock Issued to Employees*, and its related interpretations. SFAS No. 123R requires recognition of the services received in exchange for an award based on the grant-date fair value of the award. SFAS No. 123R also amends SFAS No. 95, *Statement of Cash Flows*, to require that excess tax benefits be reported as financing cash inflows, rather than as a reduction of taxes paid, which is included within operating cash flows.

The Company adopted SFAS No. 123R using the modified prospective application as permitted under SFAS No. 123R. Accordingly, prior period amounts have not been restated. Under this application, the Company is required to record compensation expense for all awards granted after the date of adoption and for the unvested portion of previously granted awards that remain outstanding at the date of adoption.

Prior to the adoption of SFAS No. 123R, the Company used the intrinsic value method as prescribed by APB Opinion No. 25, *Accounting for Stock Issued to Employees* (APB No. 25), and thus recognized no compensation expense for options granted with exercise prices equal to the fair market value of the Company s common stock on the date of grant.

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The Company has two share-based compensation plans, which are described below. The compensation cost that has been charged against income for those plans was approximately $3,901 and $6,025 for the six-month periods ended June 30, 2007 and 2006, respectively. The income tax benefit recognized for share-based compensation arrangements was approximately $1,326 and $2,049 for the six months ended June 30, 2007 and 2006, respectively.

In 1997 the Company adopted a qualified incentive stock option plan which reserved, as amended, shares (adjusted for stock exchange, dividends and exercised shares) for purchase by eligible employees. Options granted under this plan vest at the rate of 20% per year, expire not more than ten years from the date of grant, and are exercisable at not less than the fair market value of the stock at the date of the grant. This plan expired on June 1, 2007. Before the plan expired, the 43,296 remaining shares available for grant were granted.

The Company also adopted a non-qualified stock option plan in 1997, which reserved, as amended, shares (adjusted for stock exchange, dividends and exercised shares) for purchase by non-employee directors. Options granted under this plan are exercisable after six months from the date of the grant at not less than the fair market value of the stock at the date of the grant. The life of such options shall not extend more than ten years from the date of the grant. This plan also expired on June 1, 2007.

The fair value of each option award is estimated on the date of grant using the Black-Scholes option-pricing model. The risk-free interest rate is based on the U.S. Treasury rate for the expected life at the time of grant. Volatility is based on the volatilities of our trading history. The expected life is based on the average life of the options of 10 years and the weighted average graded vesting period of 5 years, and forfeitures are considered immaterial based on the historical data of the Company. The following table illustrates the assumptions for the Black-Scholes model used in determining the fair value of options granted to employees for the six months ended June 30, 2007. No options were granted during the six month period ended June 30, 2006.

	Six Months Ended June 30, 2007
Dividend yield	0.00%
Risk-free rate	4.87%
Volatility	21.59%
Expected life	10 years

A summary of option activity under the stock option plans for the six-month period ended June 30, 2007, is presented below:

	Options Available	**Options Outstanding**	**Weighted Average Exercise Price**
Balance at December 31, 2006	43,302	252,188	$ 2.74
Exercised		(175,630)	2.45
Authorized			
Forfeited			
Granted	(43,296)	43,296	13.27
Expired	(6)		
Balance at June 30, 2007		119,846	$ 6.99

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The following table sets forth the exercise prices, the number of options outstanding and the number of options exercisable at June 30, 2007:

Exercise Price	Number of Options Outstanding	Weighted Average Exercise Price	Weighted Average Contractual Life Remaining (Years)	Number of Options Exercisable	Weighted Average Exercise Price
$ 3.03	8,456	$ 3.03	2.1	8,456	3.03
3.95	13,306	3.95	3.6	13,306	