2013
ANNUAL REPORT



FB

The FARMERS BANK of APPOMATTOX

THE FARMERS BANK OF APPOMATTOX AND SUBSIDIARY

Table of Contents
As of and for the years ended December 31, 2013 and December 31, 2012

	Page
The President's Message	2
Five-year Summary of Selected Financial Data	4
Common Stock Prices and Dividends Paid	5
Report of Independent Registered Public Accounting Firm	6
Consolidated Balance Sheets	7
Consolidated Statements of Income and Comprehensive Income	8
Consolidated Statements of Changes in Stockholders' Equity	9
Consolidated Statements of Cash Flows	10
Notes to Consolidated Financial Statements	12
Directors	48
Officers	49

Notice of Annual Meeting

The Annual Meeting of Shareholders will be held at 7:30 p.m. on May 20, 2014 at The Museum of the Confederacy, 159 Horseshoe Road, Appomattox, Virginia. All shareholders are invited to attend.

Independent Registered Public Accounting Firm

Cherry Bekaert LLP
2626 Glenwood Avenue, Suite 200
Raleigh, NC 27608

Corporate Headquarters

The Farmers Bank of Appomattox
223 Main Street
Appomattox, Virginia 24522

Branches

Concord Branch
Brian D. Wilkerson, Manager
10272 Village Highway
Concord, VA 24538

Dillwyn Branch
Stephanie L. Oliver, Manager
16086 N. James Madison Highway
Dillwyn, VA 23936

Farmville Branch
James E. Duff, Manager
1508 South Main Street
Farmville, VA 23901

Main Street Branch
Thomas R. Cobb, Manager
223 Main Street
Appomattox, VA 24522

Triangle Plaza Branch
Dianne R. Rudder, Manager
169 Old Courthouse Road
Appomattox, VA 24522

THE PRESIDENT'S MESSAGE



Dear Shareholders,

On behalf of the Board of Directors and management of The Farmers Bank of Appomattox, I am pleased to present our annual report on the financial condition and results of operations of our Bank for the years ended December 31, 2013 and 2012. As we ended 2013 where we celebrated our 95th year of operation, we remain both strong and profitable. The year has been another successful one for our Bank, highlighted by growth in loans and deposits. We have continued to experience earnings above many of our peers, with net income increasing by 1.51% over 2012 earnings. We are once again dedicating ourselves to strengthening our relationships with our core customers and renewing our pledge to be a responsible member of the communities in which we operate.

During 2013 the Bank earned net income of $2.018 million, which exceeded 2012 net income of $1.988 million. The 2013 net income increase is partially the result of decreases of $220 thousand in the provision for loan losses and $109 thousand in income tax expense, which helped offset an increase of $295 thousand in non-interest expenses. The provision for loan losses declined during 2013 as net charged off loans decreased $256 thousand. Net interest income declined $22 thousand as a $257 thousand decrease in interest income outpaced a $235 thousand decrease in interest expense. The Bank's noninterest expenses increased primarily due to an increase in pension expense, expenses related to the Bank's foreclosed properties and data processing related expenses. Noninterest income increased slightly primarily due to an increase in the cash surrender value of bank-owned life insurance (BOLI). These BOLI investments generate tax-exempt income which can be used to offset future employee benefit costs.

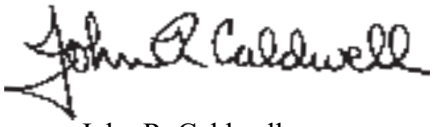
The Bank's year-end efficiency ratio of 65.04% compared very favorably with national and state peer group ratios. The Bank's return on average assets of 0.99% for 2013 also compared favorably with the average for its peer group of 0.72% per the December 31, 2013 ***Uniform Bank Performance Report***. The Board and management were also pleased that according to the 2013 ***Virginia Bank Performance Report***, our Bank ranked 17th out of 103 Virginia banks, and we are consistently listed in the Top 200 Community Banks by the ***American Bankers*** magazine.

Management saw growth in the balance sheet as well. Total assets were $201.3 million at December 31, 2013, which represented growth of $1.412 million or 0.71% compared to December 31, 2012. The Bank's 2013 asset growth resulted primarily from growth in loans of $1.527 million (1.29%). The Bank also experienced deposit growth of $4.982 million or 2.95% in 2013, with almost all types of deposits showing growth. The Bank attributes the above mentioned growth figures to the stability and increasing attractiveness of community banking.

Many of you have heard about the possibility of an additional community bank coming to our area. When our experienced banking team has been faced with competition in the past, we have always found ways to meet the challenge. We at Farmers Bank remain committed to our customers and will continue to do what we have always done…Serve our customers with the personal touch and responsiveness that they deserve. We are continually looking for ways to solidify the relationships that we have built throughout our many years of service.

In January of 2014, Alfred L. Jones, III was appointed as our newest member to the Board of Directors. Mr. Jones is Pastor of The Jesus Center and a retired Appomattox County school teacher. We hope that you will join us in welcoming him to our board. I am continually thankful for all of our dedicated and talented directors, officers and employees that have helped make 2013 such a productive year. To you, our shareholders, who have supported us throughout the years, we thank you. We continue our commitment to deliver great value for your investment.

Sincerely,



John R. Caldwell
President and Chief Executive Officer

THE FARMERS BANK OF APPOMATTOX AND SUBSIDIARY

Five-year Summary of Selected Financial Data
(In Thousands, Except Per Share Data and Selected Ratios)

	Years Ended December 31				
Income statement data	2013	2012	2011	2010	2009
Interest income	$ 8,507	$ 8,764	$ 8,956	$ 8,937	$ 8,535
Interest expense	1,257	1,492	1,775	2,137	2,441
Net interest income	7,250	7,272	7,181	6,800	6,094
Provision for loan losses	91	311	337	134	478
Net interest income after provision for loan losses	7,159	6,961	6,844	6,666	5,616
Noninterest income	1,128	1,110	963	1,017	889
Noninterest expense	5,708	5,413	5,438	5,418	4,839
Income tax expense	561	670	543	463	199
Net income	$ 2,018	$ 1,988	$ 1,826	$ 1,802	$ 1,467
Per share data:					
Basic earnings per share	$ 1.86	$ 1.83	$ 1.69	$ 1.66	$ 1.35
Cash dividends per share	$ .75	$ .65	$ .65	$ .55	$ .45
Book value at year end	$ 22.61	$ 23.17	$ 21.66	$ 19.52	$ 18.37
Balance sheet data at end of year					
Available-for-sale securities	$ 54,703	$ 49,950	$ 41,069	$ 43,488	$ 30,548
Held to maturity securities	12,374	15,641	23,494	26,552	27,923
Total loans, net	119,549	118,022	112,574	105,759	97,199
Total assets	201,344	199,932	186,240	186,219	165,755
Deposits	174,003	169,021	158,482	158,468	135,759
Stockholders' equity	24,502	25,109	23,477	21,157	19,909
Selected ratios					
Return on average assets	0.99%	1.01%	0.98%	0.98%	0.90%
Return on average equity	8.24	8.14	8.26	8.61	7.63
Dividend payout ratio	40.27	35.42	38.58	33.07	33.24
Average equity to average assets	12.02	12.45	11.85	11.40	11.81

THE FARMERS BANK OF APPOMATTOX AND SUBSIDIARY

Common Stock Prices and Dividends Paid

The common stock of the Bank is not listed on a registered exchange. However, the investment firm of Davenport and Company, LLC has agreed to execute trades.

Following are listings of the quarterly high and low sales prices of Bank stock during 2013 and 2012, based on actual sales prices known to the Bank, along with the dividends that were paid during those periods. Prices do not necessarily reflect unreported trades, which may have been at lower or higher prices.

2013	High	Low	Dividends
1st Quarter	$ 17.00	$ 15.00	$ 0.45
2nd Quarter	$ 16.80	$ 16.20	-
3rd Quarter	$ 16.70	$ 16.15	$ 0.30
4th Quarter	$ 17.75	$ 16.50	-

2012	High	Low	Dividends
1st Quarter	$ 16.50	$ 15.25	$ 0.35
2nd Quarter	$ 17.50	$ 15.75	-
3rd Quarter	$ 16.40	$ 15.25	$ 0.30
4th Quarter	$ 16.40	$ 15.06	-

As of December 31, 2013, there were 1,083,660 outstanding shares of Bank common stock, par value $2.00 per share, held by 964 shareholders of record.

The Bank is subject to certain regulatory restrictions pertaining to the amount of dividends that it may pay. The Federal Reserve restricts, without prior approval, the total dividend payments of a member bank in any calendar year to the bank's net income of that year, as defined, combined with its retained net income of the preceding two calendar years, less any required transfers to surplus. At December 31, 2013, retained earnings which are free of such restrictions amounted to approximately $3,616. Please reference Note 11 of the Notes to Consolidated Financial Statements for a discussion of dividend restrictions and capital requirements.

Cherry Bekaert LLP
CPAs & Advisors

Report of Independent Auditor

The Board of Directors and Stockholders
The Farmers Bank of Appomattox
Appomattox, Virginia

Report on the Consolidated Financial Statements
We have audited the accompanying consolidated financial statements of The Farmers Bank of Appomattox and Subsidiary (the "Company"), which comprise the consolidated balance sheets as of December 31, 2013 and 2012, and the related consolidated statements income and comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Consolidated Financial Statements
Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility
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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion
In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of The Farmers Bank of Appomattox and Subsidiary as of December 31, 2013 and 2012, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Cherry Bekaert LLP

Raleigh, North Carolina
March 14, 2014

THE FARMERS BANK OF APPOMATTOX AND SUBSIDIARY
Consolidated Balance Sheets
December 31, 2013 and 2012
(In thousands, except share and per share data)

Assets	2013	2012
Cash and cash equivalents		
Cash and due from banks	$ 3,535	$ 4,403
Federal funds sold	256	581
Total cash and cash equivalents	3,791	4,984
Securities		
Available-for-sale, at fair value	54,703	49,950
Held-to-maturity, at amortized cost	12,374	15,641
Loans, net	119,549	118,022
Bank premises and equipment, net	2,576	2,666
Accrued interest receivable	1,129	1,144
Investment in bank-owned life insurance	5,215	5,030
Prepaid pension expense	392	-
Deferred tax asset	128	-
Other assets	1,487	2,495
	197,553	194,948
Total assets	$ 201,344	$ 199,932
Liabilities and Stockholders' Equity		
Deposits		
Demand – noninterest bearing	$ 28,348	$ 25,700
Demand – interest bearing	37,091	36,754
Savings	35,360	33,098
Time:		
Certificates of deposit of $100 and over	35,525	32,836
Other	37,679	40,633
Total deposits	174,003	169,021
Securities sold under repurchase agreements	2,400	4,120
Accrued interest payable	126	149
Deferred income taxes	-	817
Accrued pension expense	-	456
Other liabilities	313	260
Total liabilities	176,842	174,823
Commitments and contingencies (Note 13)		
Stockholders' equity		
Common stock, $2 par value. Authorized 1,600,000 shares: issued and outstanding 1,083,660 shares	2,167	2,167
Surplus	1,000	1,000
Retained earnings	22,231	21,026
Accumulated other comprehensive income (loss)	(896)	916
Total stockholders' equity	24,502	25,109
Total liabilities and stockholders' equity	$ 201,344	$ 199,932

See notes to consolidated financial statements

THE FARMERS BANK OF APPOMATTOX AND SUBSIDIARY
Consolidated Statements of Income and Comprehensive Income
December 31, 2013 and 2012
(In thousands, except share and per share data)

	2013	2012
Interest income		
Interest and fees on loans	$ 6,227	$ 6,384
Interest on securities		
U. S. Government agencies	303	325
Obligations of states and political subdivisions – nontaxable	785	795
Obligations of states and political subdivisions – taxable	878	889
Corporate obligations	297	354
Corporate certificates of deposit	11	10
Interest on federal funds sold	6	7
Total interest income	8,507	8,764
Interest expense		
Interest on deposits	761	951
Interest on time certificates of $100 and over	477	517
Interest on securities sold under repurchase agreements	19	24
Total interest expense	1,257	1,492
Net interest income	7,250	7,272
Provision for loan losses	91	311
Net interest income after provision for loan losses	7,159	6,961
Noninterest income		
Service charges on deposit accounts	658	640
Gain on sales, calls or maturities of securities	28	205
Other	442	265
Total noninterest income	1,128	1,110
Noninterest expense		
Salaries and employee benefits	3,236	3,100
Expenses of premises and equipment	477	448
Other operating expenses	1,995	1,865
Total noninterest expense	5,708	5,413
Income before income tax expense	2,579	2,658
Income tax expense	561	670
Net income	2,018	1,988
Other comprehensive income		
Unrealized gains (losses) on available-for-sale securities, net of deferred income tax of ($1,161) and $207 in 2013 and 2012, respectively	(2,234)	538
Reclassification of (gains) recognized in net income, net of income tax of $9 and $70 in 2013 and 2012, respectively	(19)	(135)
Change in funded status of pension, net of deferred income tax of $226 and ($27) in 2013 and 2012, respectively	441	(55)
Comprehensive income	$ 206	$ 2,336
Per share data:		
Earnings per share	$ 1.86	$ 1.83
Cash dividends per share	$ 0.75	$ 0.65

See notes to consolidated financial statements

THE FARMERS BANK OF APPOMATTOX AND SUBSIDIARY
Consolidated Statements of Changes in Stockholders' Equity
Years Ended December 31, 2013 and 2012
(In thousands, except per share data)

	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balances at January 1, 2012	$ 2,167	$ 1,000	$ 19,742	$ 568	$ 23,477
Net income	-	-	1,988	-	1,988
Cash dividends ($0.65 per share)	-	-	(704)	-	(704)
Other comprehensive income	-	-	-	348	348
Balances at December 31, 2012	**2,167**	**1,000**	**21,026**	**916**	**25,109**
Net income	-	-	2,018	-	2,018
Cash dividends ($0.75 per share)	-	-	(813)	-	(813)
Other comprehensive income	-	-	-	(1,812)	(1,812)
Balances at December 31, 2013	**$ 2,167**	**$ 1,000**	**$ 22,231**	**$ (896)**	**$ 24,502**

See notes to consolidated financial statements

THE FARMERS BANK OF APPOMATTOX AND SUBSIDIARY
Consolidated Statements of Cash Flows
Years Ended December 31, 2013 and 2012
(In thousands)

	2013	2012
Cash flow from operating activities:		
Net income	$ 2,018	$ 1,988
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation of bank premises and equipment	180	172
Amortization of intangible asset	82	82
Loss on disposal of equipment	12	24
Gain on sale, call or maturity of investment securities	(28)	(205)
Net amortization and accretion of premiums and discounts on securities	239	181
Provision for loan losses	91	311
Provision for deferred income taxes	11	65
Increase in cash surrender value of bank-owned life insurance	(185)	(30)
Valuation write-downs of other real estate	41	-
Gain on the sale of other real estate	(4)	-
Net decrease in:		
Accrued interest receivable	15	24
Prepaid pension expense	275	-
Other assets	117	91
Net increase (decrease) in:		
Accrued interest payable	(23)	(17)
Accrued pension expense	(456)	(239)
Other liabilities	53	33
Net cash provided by operating activities	2,438	2,480
Cash flow from investing activities:		
Proceeds from sales of available-for-sale securities	1,549	4,117
Proceeds from maturities and calls of available-for-sale securities	3,600	5,911
Proceeds from maturities and calls of held to maturity securities	3,245	6,516
Proceeds from the sale of other real estate	751	-
Purchases of available-for-sale securities	(13,505)	(16,938)
Net increase in loans	(1,618)	(6,645)
Purchases of bank premises and equipment	(102)	(192)
Purchase of bank-owned life insurance	-	(5,000)
Net cash used in investing activities	(6,080)	(12,231)
Cash flow from financing activities:		
Net increase in demand deposits and savings accounts	5,247	8,667
Net increase (decrease) in time deposits	(265)	1,872
Net increase (decrease) in securities sold under repurchase agreements	(1,720)	2,256
Net (decrease) in other borrowed funds	-	(839)
Cash dividends paid	(813)	(704)
Net cash provided by financing activities	2,449	11,252
Net increase (decrease) in cash and cash equivalents	(1,193)	1,501
Cash and cash equivalents, beginning of year	4,984	3,483
Cash and cash equivalents, end of year	$ 3,791	$ 4,984

THE FARMERS BANK OF APPOMATTOX AND SUBSIDIARY
Consolidated Statements of Cash Flows
Years Ended December 31, 2013 and 2012
(In thousands)

	2013	2012
Supplemental disclosure of cash flow information		
Interest paid during the period	$ 1,280	$ 1,509
Taxes paid during the period	$ 462	$ 608
Supplemental schedule of noncash investing and financing activities		
Additions to other real estate owned	$ 196	$ 886
Unrealized gains (losses) on available-for-sale securities, net of an income income tax benefit of $(1,161) and net of income taxes of $207 in 2013 and 2012, respectively	$ (2,253)	$ 403
Unrecognized net actuarial gain (loss) in defined benefit plan, net of income taxes of $226 and net of an income tax benefit of $(27) in 2013 and 2012, respectively	$ 441	$ (55)

See notes to consolidated financial statements

Note 1 - Summary of significant accounting policies

The accounting and reporting policies of The Farmers Bank of Appomattox and its wholly owned subsidiary, Farmers Bank Financial Services, Inc., conform to accounting principles generally accepted in the United States of America ("GAAP") and general practices within the banking industry. The following is a summary of the more significant accounting policies:

Consolidation

The consolidated financial statements include the accounts of The Farmers Bank of Appomattox and its wholly-owned subsidiary (collectively, "the Bank"). The wholly-owned subsidiary, Farmers Bank Financial Services, Inc., is utilized to account for the Bank's investment in two insurance companies. All significant intercompany balances and transactions have been eliminated in the consolidation.

Use of Estimates

In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the dates of the consolidated balance sheets and income and expenses for each year. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant changes in the near term relate to determination of the allowance for loan losses and the fair value of investment securities.

Cash and cash equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks and federal funds sold.

Securities

The Bank classifies its securities in two categories: (1) debt securities that the Bank has the positive intent and ability to hold to maturity are classified as "held to maturity securities" and reported at amortized cost. Amortization of premiums and accretion of discounts are adjusted on a basis which approximates the level yield method; and (2) debt and equity securities not classified as held to maturity securities are classified as "available-for-sale securities" and reported at fair value, with unrealized gains and losses excluded from net income and reported in a separate component of stockholders' equity.

Gains or losses on disposition of securities are based on the net proceeds and adjusted carrying values of the securities matured, called or sold, using the specific identification method on a trade date basis. A decline in the market value of any available-for-sale or held to maturity security below cost that is deemed other than temporary is charged to net income, resulting in the establishment of a new cost basis for the security.

Management evaluates securities for other-than-temporary impairment ("OTTI") on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell or it is more likely than not it will be required to sell a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings.

Note 1 - Summary of significant accounting policies (continued)

Securities

For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement, and 2) OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through earnings.

Loans and allowance for loan losses

Loans are stated at the amount of unpaid principal, reduced by unearned income and fees on loans and an allowance for loan losses. The allowance for loan losses is a valuation allowance consisting of the cumulative effect of the provision for loan losses, plus any amounts recovered on loans previously charged off, minus loans charged off. The provision for loan losses is charged to expense. Loans are charged against the allowance for loan losses when management believes the collectability of the principal is unlikely.

Modifications to a borrower's debt agreement are considered troubled debt restructurings ("restructurings") if a concession is granted for economic or legal reasons related to a borrower's financial difficulties that otherwise would not be considered. Restructurings are undertaken in order to improve the likelihood of recovery on the loan and may take the form of modifications made with the stated interest rate lower than the current market rate for new debt with similar risk; modifications to the terms and conditions of the loan that fall outside of normal underwriting policies and procedures, or a combination of these modifications. Restructurings can involve loans remaining in nonaccrual status, moving to nonaccrual status, or continuing on accruing status, depending on the individual facts and circumstances of the borrower.

Loans are considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impaired loans are measured based on the present value of expected future cash flows, discounted at the loan's effective interest rate or at the fair value of the collateral less the estimated selling costs, if the loan is collateral dependent. Larger groups of homogeneous loans such as real estate mortgage loans, individual consumer loans and home equity loans are evaluated collectively for impairment. Impairment losses are recorded as a charge to the allowance for loan losses. Cash receipts on impaired loans receivable are applied first to reduce interest on such loans to the extent of interest contractually due, and any remaining amounts are applied to principal.

The allowance for loan losses is an amount management believes will be adequate to absorb probable losses inherent in the loan portfolio. Management determines the adequacy of the allowance based upon reviews of individual credits, delinquencies, current economic conditions, the risk characteristics of the various categories of loans, recent loan loss experience and other pertinent factors. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions. It is reasonably possible that management's estimate of loan losses and the related allowance may change materially in the near term. However, the amount of that change cannot be estimated. Various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses. Such agencies may require the Bank to recognize additions to the allowance for loan losses based on their judgments about information available at the time of their examinations.

Note 1 - Summary of significant accounting policies (continued)

Loans and allowance for loan losses

Loans are considered past due when the contractual amounts due with respect to principal and interest are not received within 30 days of their contractual due date. Loans are generally placed in non-accrual status if they are 90 or more days past due unless they are well secured and in process of collection. Interest related to non-accrual loans is recognized on the cash basis. Loans in non-accrual status are generally the collectible portion of bankrupt accounts. Loans are generally charged off when the collection of principal and interest is 90 days or more past due and the loan is considered uncollectible.

Loan origination fees and the corresponding loan origination costs are deferred, and the net amount is amortized over the contractual life of the related loans as an adjustment of yield.

Bank premises and equipment

Bank premises and equipment are stated at cost, net of accumulated depreciation. Depreciation on bank premises and equipment is charged to expense over the estimated useful lives of the assets, principally on the straight-line method. The cost of assets retired and sold and the related accumulated depreciation are eliminated from the accounts and the resulting gains or losses are included in determining net income. Expenditures for maintenance and repairs are charged to expense as incurred, and improvements and betterments are capitalized.

Other Real Estate Owned

Other real estate owned consists of properties acquired through foreclosure sales or deed in lieu of foreclosure. At the time of the foreclosure, the properties are recorded at the fair value less estimated costs to sell the property. Subsequently these properties are carried at the lower of cost or fair value less the estimated costs to sell the property. Losses from the acquisition of property in full or partial satisfaction of loans are charged against the allowance for loan losses. Subsequent write-downs, if any, are charged to expense. Gains and losses on the sales of foreclosed properties are included in determining net income in the year of the sale. At December 31, 2013 and 2012, the Bank had foreclosed assets totaling $697 and $1,289, respectively. These assets are reported within other assets in the Bank's consolidated balance sheets.

Defined benefit pension plan

The Bank maintains a noncontributory defined benefit pension plan covering substantially all of its employees. The overfunded or underfunded status of the pension plan is recognized as an asset or liability in the statement of financial position and changes in the funded status are recognized in comprehensive income. The net periodic pension expense includes a service cost component, interest on the projected benefit obligation, a component reflecting the actual return on plan assets, and the effect of deferring and amortizing certain actuarial gains and losses. The Bank's normal funding policy is to contribute to the pension plan amounts necessary to satisfy the Internal Revenue Service's funding standards and to the extent that they are deductible for federal income tax purposes.

Note 1 - Summary of significant accounting policies (continued)

Intangible assets

Intangible assets are non-financial assets that lack physical substance and that provide an entity with various benefits. Generally, intangible assets are separated into those with finite useful lives, which are amortized, and those with indefinite useful lives, which are not amortized. The Bank's intangible asset consists of a core deposit intangible acquired in the Longwood Village branch purchase and assumption in January 2010. The initial core deposit intangible in 2010 totaled $409 and was determined based on a fair value assessment of the deposits assumed in the transaction and is being amortized over a five-year period. As of December 31, 2013 and 2012, the core deposit intangible balance was $81 and $163, respectively.

Bank-owned life insurance

During 2012, the Bank purchased life insurance on key employees in the face amount of $15,397. The policy was recorded at the cash surrender value and reported in other assets on the balance sheet. Income generated from the policy is recorded as non-interest income.

Advertising
The Bank expenses advertising costs as incurred.

Income taxes

Income taxes are recorded using the asset and liability method, whereby deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry-forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in net income in the period that includes the enactment date.

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes that it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination.

Earnings per share

Earnings per share is computed based on the weighted-average number of shares outstanding during each year. The weighted-average number of common shares outstanding was 1,083,660 for 2013 and 2012.

Note 1 - Summary of significant accounting policies (continued)

Comprehensive income

Accounting Standards Codification ("ASC") 220-10, *Comprehensive Income*, requires the Bank to classify items of "Other Comprehensive Income" (such as net unrealized gains (losses) on available-for-sale securities) by their nature in a financial statement and present the accumulated balance of other comprehensive income separately from retained earnings and surplus in the equity section of a statement of financial position. The Bank's other comprehensive income consists of the change in the net unrealized gains (losses) on securities available-for-sale, net of income taxes, and the change in the funded status of the Bank's defined benefit pension plan, net of income taxes.

Note 2 - Restrictions on cash

To comply with Federal Reserve regulations, the Bank is required to maintain certain average cash reserve balances. The daily average cash reserve requirements were approximately $1,514 and $1,467 for the specified review weeks in December 2013 and 2012, respectively.

Note 3 - Securities

The amortized costs, gross unrealized gains, gross unrealized losses and fair values of securities are as follows:

	December 31, 2013			
	Amortized Costs	Gross Unrealized Gains	Gross Unrealized Losses	Fair Values
Available-for-sale				
U.S. Government agencies	$ 11,576	$ 49	$ (449)	$ 11,176
Obligations of states and political subdivisions - nontaxable	20,080	122	(1,080)	19,122
Obligations of states and political subdivisions - taxable	15,343	586	(87)	15,842
Corporate	7,003	380	(68)	7,315
Corporate certificates of deposit	1,245	3	-	1,248
	$ 55,247	$ 1,140	$ (1,684)	$ 54,703
Held to maturity				
U.S. Government agencies	$ 2,867	$ 131	$ -	$ 2,998
Obligations of states and political subdivisions - nontaxable	5,540	332	-	5,872
Obligations of states and political subdivisions - taxable	3,967	262	(5)	4,224
	$ 12,374	$ 725	$ (5)	$ 13,094

Note 3 – Securities (continued)

	December 31, 2012			
	Amortized Costs	Gross Unrealized Gains	Gross Unrealized Losses	Fair Values
Available-for-sale				
U.S. Government agencies	$ 5,558	$ 127	$ -	$ 5,685
Obligations of states and political subdivisions - nontaxable	18,706	567	(31)	19,242
Obligations of states and political subdivisions - taxable	16,203	1,683	-	17,886
Corporate	5,866	522	-	6,388
Corporate certificates of deposit	747	2	-	749
	$ 47,080	$ 2,901	$ (31)	$ 49,950
Held to maturity				
U.S. Government agencies	$ 3,874	$ 266	$ -	$ 4,140
Obligations of states and political subdivisions - nontaxable	7,797	549	-	8,346
Obligations of states and political subdivisions - taxable	3,970	424	-	4,394
	$ 15,641	$ 1,239	$ -	$ 16,880

The amortized costs and fair values of securities at December 31, 2013, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available-for-Sale		Held to Maturity	
	Amortized Cost	Fair Values	Amortized Cost	Fair Values
Due in one year or less	$ 7,541	$ 7,269	$ 1,617	$ 1,635
Due after one year through five years	18,824	19,386	7,706	8,258
Due after five years through ten years	26,212	25,588	3,051	3,201
Due after ten years	2,670	2,460	-	-
	$ 55,247	$ 54,703	$ 12,374	$ 13,094

The amortized costs of securities pledged to collateralize public deposits and securities sold under repurchase agreements and for other purposes as required or permitted by law were approximately $13,662 and $10,539 (fair value of $13,662 and $11,062, respectively) at December 31, 2013 and 2012, respectively.

Note 3 – Securities (continued)

During 2013 and 2012, the Bank sold available-for-sale securities with amortized costs totaling $1,521 and $3,933, respectively. Gross realized gains on these sales were $28 and $184, respectively, while there were no gross realized losses on the sales in either year. Also during 2013 and 2012, the Bank had called and matured securities with amortized costs totaling $6,845 and $12,406, respectively. Gross realized gains on the called and matured securities were $0 and $21, respectively, and there were no realized losses on these securities.

The following table shows the gross unrealized losses and fair value of the Bank's investments, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2013 and 2012:

	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
December 31, 2013:						
U. S. Government agencies	$ 8,609	$ (449)	$ -	$ -	$ 8,609	$ (449)
Obligations of state and political subdivisions	14,470	(1,034)	2,043	(138)	16,513	(1,172)
Corporate	2,073	(68)	-	-	2,073	(68)
Total	$ 25,152	$ (1,551)	$ 2,043	$ (138)	$ 27,195	$ (1,689)

	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
December 31, 2012:						
Obligations of state and political subdivisions	$ 2,187	$ (31)	$ -	$ -	$ 2,187	$ (31)
Corporate CDs	249	-	-	-	249	-
Total	$ 2,436	$ (31)	$ -	$ -	$ 2,436	$ (31)

As of December 31, 2013 and 2012, the Bank held $27,195 and $2,436, respectively, in securities with unrealized losses. These unrealized losses are all related to the change in market interest rates and not to the credit quality of the issuers. When analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and industry analysts' reports. As management has the ability and intent to hold debt securities for the foreseeable future, no declines are deemed to be other-than-temporary.

Note 4 - Loans and allowance for loan losses

A summary of loans, net is as follows:

	December 31	
	2013	2012
Commercial loans	$ 8,039	$ 10,727
Real estate construction loans	7,131	6,506
Real estate mortgage loans	84,645	80,434
Consumer loans	20,647	21,270
Total loans, gross	120,462	118,937
Less unearned income and fees	(220)	(186)
Loans, net of unearned income and fees	120,242	118,751
Less allowance for loan losses	(693)	(729)
Loans, net	$ 119,549	$ 118,022

Following is a breakdown of real estate mortgage loans:

	December 31	
Real estate mortgage loans:	2013	2012
Commercial mortgage loans	$ 19,774	$ 19,693
1 – 4 family residential mortgages	47,177	44,194
Home equity lines of credit	15,348	15,388
Other mortgages	2,346	1,159
Total real estate mortgage loans	$ 84,645	$ 80,434

Loan origination / Risk management. The Bank has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. Management reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing management with frequent reports related to loan production, loan quality, concentrations of credit, loan delinquencies and non-performing and potential problem loans. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions. The primary categories of loans originated by the Bank are real estate mortgage loans, real estate construction and land development loans, commercial loans and consumer loans.

Note 4 - Loans and allowance for loan losses (continued)

Real estate mortgage loans are primarily underwritten as cash flow loans and secondarily as loans secured by real estate. Commercial real estate mortgage loans are subject to underwriting standards and processes similar to commercial loans where evaluation of the borrower's ability to operate profitably and repay their obligations as agreed is critical to the underwriting process. Commercial real estate lending typically involves higher loan principal amounts, and the repayment of these loans is generally dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy.

Real estate construction and land development loans are generally based upon estimates of costs and value associated with the complete project. These loans often involve the disbursement of substantial funds with repayment dependent on the ultimate success of the project. Management is aware that cost estimates may be inaccurate, thus physical inspections of the property during the construction phase to assess whether the estimated percentage of completeness is in line with the requested loan advance is critical to the loan management process. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property, or some other interim loan commitment provided while permanent financing is being obtained. These loans are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, governmental regulation of the property, general economic conditions, and the availability of permanent financing.

Residential real estate mortgage loans are primarily underwritten based on an assessment of the borrower's credit history and estimated ability to repay the mortgage loan based on a comparison of the borrower's verified income and current obligations, including the requested loan. The value of the property securing the loan is generally determined by an independent real estate appraisal. The Bank generally lends up to 80% of the value of the property, thus mitigating the risk associated with these loans. Home equity loans are also underwritten utilizing a maximum loan to value percentage of 80%.

Commercial loans are underwritten after evaluating and understanding the borrower's ability to operate profitably and prudently expand its business. Once it is determined that the borrower's management possesses sound ethics and solid business acumen, the Bank's management examines current and projected cash flows to determine the ability of the borrower to repay their obligations as agreed. Commercial loans are primarily made based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. Management is aware that the cash flows of the borrower may not match projections and collateral securing these loans may fluctuate in value. Most commercial loans are secured by the assets being financed or other business assets such as inventory or equipment and may incorporate a personal guarantee. Some smaller amount, short-term loans are made on an unsecured basis.

The Bank typically originates consumer loans utilizing an independent, third-party credit bureau report to supplement the underwriting process. Consumer loans are primarily made based on an assessment of the borrower's credit history and the estimated ability to repay the borrower's obligations based on a comparison of the borrower's stated income to existing obligations, including the loan being requested. These loans are generally secured by the asset being purchased, secured by unencumbered assets already owned by the borrower or unsecured. The risk associated with consumer loans is minimized by the relatively small amount of the loans spread among a large number of borrowers.

Note 4 - Loans and allowance for loan losses (continued)

The Bank maintains an independent loan administration department that reviews all loan documentation for accuracy, completeness, and compliance with Bank policies and procedures. Results of these reviews are presented to management. The loan administration process compliments and reinforces the risk identification and assessment decisions made by lenders.

In the ordinary course of business, the Bank has granted loans to certain directors, executive officers, and their affiliates (collectively referred to as "related parties"). These loans were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other unaffiliated persons and do not involve more than normal risk of collectability. Activity in related party loans in 2013 and 2012 is presented in the following table:

	2013	2012
Balance of related party loans, January 1	$ 238	$ 144
Principal additions	-	129
Principal reductions	(209)	(35)
Balance of related party loans, December 31	$ 29	$ 238

Non-accrual loans, segregated by type of loan, as of December 31, 2013 and 2012, were as follows:

	2013	2012
1-4 family residential real estate mortgages	$ 2	$ 6
Commercial mortgage loans	10	-
Real estate construction and land development loans	-	116
Consumer loans	67	71
Total non-accrual loans	$ 79	$ 193

Had non-accrual loans performed in accordance with their original contract terms, the Bank would have recognized additional interest income, net of income tax, of approximately $10 in 2013 and $44 in 2012.

Note 4 - Loans and allowance for loan losses (continued)

An age analysis of past due loans, segregated by type of loan, as of December 31, 2013 and 2012 is as follows:

	Loans 30-89 Days Past Due	Loans 90 or more Days Past Due	Total Past Due Loans	Current Loans	Total Loans	Accruing Loans 90 or More Days Past Due
December 31, 2013:						
Real estate mortgage loans:						
Commercial mortgages	$ 152	$ 10	$ 162	$ 19,542	$ 19,704	$ -
1-4 family res. Mortgages	966	333	1,299	45,659	46,958	331
Home equity lines of credit	253	-	253	15,100	15,353	-
Other mortgages	23	-	23	2,323	2,346	-
Real estate construction loans	256	-	256	6,851	7,107	-
Commercial loans	166	25	191	7,857	8,048	25
Consumer loans	1,051	161	1,212	19,514	20,726	94
Total	$ 2,867	$ 529	$ 3,396	$ 116,846	$ 120,242	$ 450
December 31, 2012:						
Real estate mortgage loans:						
Commercial mortgages	$ 14	$ 10	$ 24	$ 20,798	$ 20,822	$ 10
1-4 family res. Mortgages	1,693	21	1,714	42,289	44,003	15
Home equity lines of credit	157	-	157	15,235	15,392	-
Other mortgages	24	-	24	1,133	1,157	-
Real estate construction loans	484	414	898	5,590	6,488	298
Commercial loans	190	179	369	9,173	9,542	179
Consumer loans	1,069	87	1,156	20,191	21,347	19
Total	$ 3,631	$ 711	$ 4,342	$ 114,409	$ 118,751	$ 521

Loans are considered impaired when, based on current information and events, it is probable the Bank will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. Impairment is evaluated in total for smaller-balance loans of a similar nature and on an individual loan basis for other loans. If a loan is impaired, a specific valuation allowance is allocated, if necessary, so that the loan is reported net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Interest payments on impaired loans are typically applied to principal unless collectability of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

Note 4 - Loans and allowance for loan losses (continued)

The following table provides a breakdown of the Bank's impaired loans by loan type and recorded investment amounts as of December 31, 2013 and 2012. The Bank received interest payments totaling $56 and $69 on these loans during 2013 and 2012, respectively.

	Impaired Loans with no Allowance	Impaired Loans with Allowance	Total Impaired Loans	Related Allowance	Average Impaired Loans
December 31, 2013:					
Real estate mortgage loans:					
Commercial mortgages	$ 171	$ -	$ 171	$ -	$ 181
1-4 family residential mortgages	729	-	729	-	737
Home equity lines of credit	58	58	116	1	116
Other mortgages	17	-	17	-	19
Real estate construction loans	-	-	-	-	19
Commercial loans	92	33	125	8	143
Consumer loans	-	32	32	13	14
Total	$ 1,067	$ 123	$ 1,190	$ 22	$ 1,229
December 31, 2012:					
Real estate mortgage loans:					
Commercial mortgages	$ 179	$ -	$ 179	$ -	$ 171
1-4 family residential mortgages	808	-	808	-	865
Home equity lines of credit	9	107	116	3	48
Other mortgages	21	-	21	-	23
Real estate construction loans	232	63	295	26	793
Commercial loans	130	38	168	10	151
Consumer loans	12	3	15	3	29
Total	$ 1,391	$ 211	$ 1,602	$ 42	$ 2,080

Credit Quality Indicators. As part of the ongoing monitoring of the credit quality of the Bank's loan portfolio, management reviews certain credit quality indicators including (i) commercial loans with an outstanding balance of $200 or greater; (ii) loans which are past due more than 30 days; (iii) loan charge offs and recoveries; (iv) non-accrual loans and (v) the general economic conditions in the Bank's market and surrounding areas. Commercial loans with a balance of $200 or greater are reviewed quarterly to determine whether the loan should be classified. Management reviews all loans which are past due more than 30 days and two or more payments on a monthly basis. These loans are discussed with the Board of Directors at its monthly meeting. Loan charge offs and recoveries and non-accrual loans are also reported to the Board of Directors on a monthly basis. The local general economic conditions are detailed in a written report presented to the Board of Directors on a quarterly basis. This report is also included in the Bank's quarterly classified loan report. Management utilizes sources such as the local newspapers, local, state and national economic statistics (such as unemployment statistics), and other internet articles to prepare this report.

Note 4 - Loans and allowance for loan losses (continued)

The Bank utilizes a risk rating matrix to assign a risk grade to each of its loans. A description of the general characteristics of the risk grades is as follows:

Excellent / Satisfactory – These loans range from having minimal to acceptable credit risk.

Watch – These loans have acceptable credit risk but are beginning to develop potential weaknesses that may be temporary in nature but must be watched.

Other Assets Especially Mentioned ("OAEM") – These loans have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan at some future date.

Substandard – These loans are inadequately protected by the net worth or paying capacity of the borrower, and repayment may become dependent on liquidation of the underlying collateral. These loans have well-defined weaknesses, with the Bank likely sustaining a loss if the deficiencies are not corrected.

Doubtful – These loans have all of the weaknesses inherent in those classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of the currently existing facts, conditions and values, highly questionable and improbable.

Loss – These loans are in a non-accrual status and in the process of collateral liquidation.

The following table provides a breakdown of the Bank's loans by risk grade as of December 31, 2013 and 2012.

	Real estate mortgage loans	Real estate construction loans	Commercial loans	Consumer loans	Total
December 31, 2013					
Excellent / Satisfactory	$ 75,127	$ 5,418	$ 6,659	$ 20,485	$ 107,689
Watch	961	1,447	-	85	2,493
OAEM	2,876	111	977	-	3,964
Substandard	5,397	131	412	156	6,096
Doubtful	-	-	-	-	-
Loss	-	-	-	-	-
Total	$ 84,361	$ 7,107	$ 8,048	$ 20,726	$ 120,242
December 31, 2012					
Excellent / Satisfactory	$ 71,508	$ 5,948	$ 6,286	$ 21,257	$ 104,999
Watch	1,722	292	764	11	2,789
OAEM	2,887	111	1,750	60	4,808
Substandard	5,257	137	742	19	6,155
Doubtful	-	-	-	-	-
Loss	-	-	-	-	-
Total	$ 81,374	$ 6,488	$ 9,542	$ 21,347	$ 118,751

Note 4 - Loans and allowance for loan losses (continued)

The allowance for loan losses is a reserve established through a provision for loan losses charged to expense, which represents management's best estimate of probable losses inherent within the existing portfolio of loans. The Bank's allowance for loan loss methodology includes allowance allocations calculated in accordance with ASC Topic 310, "*Receivables*" and allowance allocations calculated in accordance with ASC Topic 450, "*Contingencies*". Accordingly, the methodology is based on historical loss experience by type of credit, specific homogeneous risk pools and specific loss allocations with adjustments for current events and conditions. The Bank's process for determining the appropriate level of the allowance for loan losses is designed to account for credit deterioration as it occurs. The provision for loan losses reflects loan quality trends, including the levels of and trends related to non-accrual loans, past due loans, potential problem loans, criticized loans and charge offs and recoveries, among other factors. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management's judgment, should be charged off. While management utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond management's control, including, among other things, the performance of the Bank's loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications.

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

The allowances for loan losses on specific loans are based on a regular analysis and evaluation of the specific loans. On a quarterly basis, commercial and industrial loans and commercial real estate loans with a balance of $200 or greater are evaluated. Certain of these loans with potential problems are given an internal classification which reflects management's assessment of the borrower's ability to repay the loan, the estimated value of the underlying collateral and the economic environment and industry in which the borrower operates. The regular analysis and evaluation of problem loans is performed by the loan officers and independently reviewed and approved by the Chief Compliance Officer. Generally specific allowances are based on the difference between the estimated value of the underlying collateral and the balance of the loan if the loan is deemed collateral dependent. The specific allowances are determined by the Chief Compliance Officer.

The Bank also determines specific valuation allowances for certain past due loans and non-accrual loans. Estimated loss ratios are applied to the balances of these loans collectively to determine the amount of the allowance. Loans past due sixty or more days are grouped in pools of similar loans with similar characteristics which currently include consumer, commercial and industrial and real estate loans. The estimated loss ratio is applied to each pool of past due loans less any loans in the pool for which a specific allowance valuation has already been determined. Likewise, non-accrual loans are grouped into pools of secured and unsecured loans, from which non-accrual loans with specific valuation allowances are subtracted prior to application of the historical loss ratios.

Note 4 - Loans and allowance for loan losses (continued)

Historical valuation allowances are calculated based on the historical loss experience of specific types of loans. Management calculates historical loss ratios for pools of similar loans with similar characteristics based on the proportion of net charged off loans to the total populations of loans in the pool. The historical loss ratios are updated quarterly based on the charge off loan totals for the most recent twelve quarters. The historical valuation allowance is established for each pool of similar loans based on the product of the historical loss ratio and the total dollar amount of loans in the pool less those loans in the pool for which a specific valuation allowance has been determined. The Bank's pools of similar loans currently include consumer, commercial and industrial, real estate and real estate construction loans.

A general valuation allowance based on general economic conditions is also calculated. An economic analysis is performed by the Chief Compliance Officer based on such factors as the Bank's market area industries, local, state and national unemployment statistics, general local economic conditions and local real estate market conditions. The Bank has identified five categories of economic conditions ranging from "very good economic conditions" to "major problematic economic conditions", and a loss rate is estimated for each category. The economic allowance is calculated by applying the estimated loss rate to the total loan population less loans for which a specific valuation has been determined.

The following table details activity in the allowance for loan losses by loan category for the years ended December 31, 2013 and 2012. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

	Real estate mortgage loans	Real estate construction loans	Commercial loans	Consumer loans	Total
Balance, December 31, 2012	$ 289	$ 112	$ 45	$ 283	$ 729
Charged-off loans	(26)	(24)	-	(150)	(200)
Loan recoveries	24	-	4	45	73
Provision for loan losses	4	(1)	(17)	105	91
Balance, December 31, 2013	$ 291	$ 87	$ 32	$ 283	$ 693
Allowance for loan losses allocated to:					
Loans individually evaluated for Impairment	$ 1	$ -	$ 8	$ 13	$ 22
Loans collectively evaluated for Impairment	290	87	24	270	671
Allowance for loan losses, Dec. 31, 2013	$ 291	$ 87	$ 32	$ 283	$ 693

Note 4 - Loans and allowance for loan losses (continued)

	Real estate mortgage loans	Real estate construction loans	Commercial loans	Consumer loans	Total
Balance, December 31, 2011	$ 287	$ 77	$ 85	$ 352	$ 801
Charged-off loans	(59)	(174)	-	(206)	(439)
Loan recoveries	3	-	1	52	56
Provision for loan losses	58	209	(41)	85	311
Balance, December 31, 2012	$ 289	$ 112	$ 45	$ 283	$ 729
Allowance for loan losses allocated to:					
Loans individually evaluated for Impairment	$ 3	$ 26	$ 10	$ 3	$ 42
Loans collectively evaluated for Impairment	286	86	35	280	687
Allowance for loan losses, Dec. 31, 2012	$ 289	$ 112	$ 45	$ 283	$ 729

The Bank's total loans related to each balance in the allowance for loan losses by loan type and disaggregated on the basis of the Bank's impairment methodology as of December 31, 2013 and 2012 were as follows:

	Real estate mortgage loans	Real estate construction loans	Commercial loans	Consumer loans	Total
December 31, 2013:					
Loans individually evaluated for Impairment	$ 1,033	$ -	$ 125	$ 32	$ 1,190
Loans collectively evaluated for Impairment	83,328	7,107	7,923	20,694	119,052
Total loans evaluated for impairment	$ 84,361	$ 7,107	$ 8,048	$ 20,726	$120,242
December 31, 2012:					
Loans individually evaluated for Impairment	$ 1,124	$ 295	$ 168	$ 15	$ 1,602
Loans collectively evaluated for Impairment	79,054	6,193	10,570	21,332	117,149
Total loans evaluated for impairment	$ 80,178	$ 6,488	$ 10,738	$ 21,347	$118,751

Note 5 – Troubled Debt Restructurings

ASC 310-40-20 defines a troubled debt restructuring as a restructuring of debt where a creditor for economic or legal reasons related to a debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. The concession is granted by the creditor in an attempt to protect as much of its investment as possible. The concession either stems from an agreement between the creditor and the debtor or is imposed by law or a court. Troubled debt restructurings include modification of the terms of a debt, such as a reduction of the stated interest rate for the remaining original life of the debt, an extension of the maturity date or dates at a stated interest rate lower than the current market rate for new debt with similar risk, a reduction of the face amount or maturity amount of the debt as stated in the instrument or other agreement, or a reduction of accrued interest.

Management reviews all restructured loans that occur during the year for identification as troubled debt restructurings. Management identified as troubled debt restructurings certain loans for which the allowance for loan losses had previously been measured under a general allowance for loan losses methodology (ASC 450-20). Upon identifying the reviewed loans as troubled debt restructurings, management also identified them as impaired under the guidance in ASC 310-10-35.

Modification Categories The Bank offers a variety of modifications to borrowers. The modification categories offered can generally be described in the following categories:

Rate Modification – A modification in which the interest rate is changed.

Term Modification – A modification in which the maturity date, timing of payments, or frequency of payments is changed.

Interest Only Modification – A modification in which the loan is converted to interest only payments for a period of time.

Payment Modification – A modification in which the dollar amount of the payment is changed, other than an interest only modification as described above.

Combination Modification – Any other type of modification, including the use of multiple categories above.

Note 5 – Troubled Debt Restructurings (continued)

The following tables present troubled debt restructurings as of December 31, 2013 and 2012:

	December 31, 2013			
	Number of Contracts	Accrual Status	Non-Accrual Status	Total Modifications
Real estate mortgage loans:				
Commercial mortgages	2	$ 86	$ -	$ 86
1-4 Family residential mortgages	10	675	-	675
Home equity lines of credit	-	-	-	-
Other mortgages	-	-	-	-
Real estate construction loans	-	-	-	-
Commercial loans	2	160	-	160
Consumer loans	20	166	2	168
Total	34	$ 1,087	$ 2	$ 1,089

	December 31, 2012			
	Number of Contracts	Accrual Status	Non-Accrual Status	Total Modifications
Real estate mortgage loans:				
Commercial mortgages	1	$ 66	$ -	$ 66
1-4 Family residential mortgages	9	646	-	646
Home equity lines of credit	-	-	-	-
Other mortgages	-	-	-	-
Real estate construction loans	1	18	-	18
Commercial loans	1	61	-	61
Consumer loans	18	138	4	142
Total	30	$ 929	$ 4	$ 933

Note 5 – Troubled Debt Restructurings (continued)

The following tables present newly restructured loans, broken down by type of modification, that occurred during the years ended December 31, 2013 and 2012:

Year Ended December 31, 2013

		Type of Modification					
Pre-Modification Outstanding Recorded Investment	No. of contracts	Rate	Term	Interest Only	Payment	Combination	Total
Real estate mortgage loans:							
Commercial mortgages	2	$ -	$ -	$ -	$ 66	$ 23	$ 89
1-4 Family residential mortgages	3	-	20	35	-	23	78
Home equity lines of credit	-	-	-	-	-	-	-
Other mortgages	-	-	-	-	-	-	-
Real estate construction loans	-	-	-	-	-	-	-
Commercial loans	2	-	-	-	-	171	171
Consumer loans	12	-	-	-	5	96	101
Total	19	$ -	$ 20	$ 35	$ 71	$ 313	$ 439
Post-Modification Outstanding Recorded Investment							
Real estate mortgage loans:							
Commercial mortgages	2	$ -	$ -	$ -	$ 64	$ 23	$ 87
1-4 Family residential mortgages	3	-	22	35	-	41	98
Home equity lines of credit	-	-	-	-	-	-	-
Other mortgages	-	-	-	-	-	-	-
Real estate construction loans	-	-	-	-	-	-	-
Commercial loans	1	-	-	-	-	113	113
Consumer loans	12	-	-	-	4	89	93
Total	18	$ -	$ 22	$ 35	$ 68	$ 266	$ 391

Note 5 – Troubled Debt Restructurings (continued)

Year Ended December 31, 2012

Pre-Modification Outstanding Recorded Investment	No. of contracts	Type of Modification: Rate	Term	Interest Only	Payment	Combination	Total
Real estate mortgage loans:							
Commercial mortgages	1	$ -	$ 66	$ -	$ -	$ -	$ 66
1-4 Family residential mortgages	3	-	-	39	-	159	198
Home equity lines of credit	-	-	-	-	-	-	-
Other mortgages	-	-	-	-	-	-	-
Real estate construction loans	-	-	-	-	-	-	-
Commercial loans	1	-	29	-	-	-	29
Consumer loans	3	-	23	-	-	43	66
Total	8	$ -	$ 118	$ 39	$ -	$ 202	$ 359
Post-Modification Outstanding Recorded Investment							
Real estate mortgage loans:							
Commercial mortgages	1	$ -	$ 66	$ -	$ -	$ -	$ 66
1-4 Family residential mortgages	3	-	-	35	-	166	201
Home equity lines of credit	-	-	-	-	-	-	-
Other mortgages	-	-	-	-	-	-	-
Real estate construction loans	-	-	-	-	-	-	-
Commercial loans	-	-	-	-	-	-	-
Consumer loans	3	-	22	-	-	41	63
Total	7	$ -	$ 88	$ 35	$ -	$ 207	$ 330

The following table presents restructured loans with a payment default which occurred within 12 months of the restructuring date, and during the years ended December 31, 2013 and 2012:

Type of Loan	Year Ended December 31, 2013: Number of contracts	Recorded Investment	Year Ended December 31, 2012: Number of contracts	Recorded Investment
Real estate mortgage loans:				
Commercial mortgages	1	$ 23	1	$ 66
1 – 4 Family residential mortgage	1	41	2	53
Real estate construction loans	-	-	-	-
Commercial loans	1	113	-	-
Consumer loans	4	14	1	19
Total	7	$ 191	4	$ 138

Note 6 - Bank premises and equipment

A summary of bank premises and equipment stated at cost, less accumulated depreciation, follows:

	December 31	
	2013	2012
Land	$ 465	$ 465
Buildings and improvements	3,255	3,255
Equipment, furniture and fixtures	2,084	2,688
	5,804	6,408
Less accumulated depreciation	(3,228)	(3,742)
Net bank premises and equipment	$ 2,576	$ 2,666

Note 7 – Bank-owned life insurance

During 2012, the Bank purchased life insurance on key employees in the face amount of $15,397. Generally accepted accounting standards require that these policies are recorded at the cash surrender value, net of surrender charges and/or early termination charges. As of December 31, 2013 and 2012, the BOLI cash surrender value was $5,215 and $5,030, respectively, resulting in other income of $186 and $30 in 2013 and 2012, respectively. The increases in the cash surrender values resulted in an annualized net yield of 3.33% (5.55% on a pre-tax equivalent basis) in 2013 and 3.80% (6.33% on a pre-tax equivalent basis) in 2012.

Note 8 - Pension plans

Effective January 1, 2012 the Bank amended its defined benefit pension plan (the "Plan") converting it to a cash-balance pension plan whereby benefits earned by participants under the plan through December 31, 2011 were converted to an opening account balance for each participant. The opening balance was calculated based on IRS mandated assumptions for lump sum payouts. Eligibility under the cash-balance plan is the same as the previous defined benefit pension plan except the vesting period was shortened from five years to three years. Benefits under the cash-balance plan are computed based on graduated earnings rates determined by employees' years of credited service as of December 31, 2011, plus interest at rates pre-set by management and the cash-balance plan administrators. As with the previous defined benefit pension plan, assets are invested in a balanced fund, fixed income fund and equity fund administered by the Virginia Bankers Association. As of December 31, 2011, no new entrants will be allowed into the Plan.

The Bank complies with ASC 715, *Compensation – Retirement Benefits,* which requires management to present in the statement of financial position the funded status of the plan as an asset (overfunded) or liability (underfunded) with any unrecognized actuarial gain (loss), prior service costs, or transition amount from the adoption of ASC 715, shown as an adjustment to the accumulated other comprehensive income.

Note 8 - Pension plans (continued)

Amounts recognized in accumulated other comprehensive income consist of an unrecognized net actuarial loss and an unrecognized prior service cost, both net of deferred income tax. The unrecognized net actuarial loss decreased $742 during the year ended December 31, 2013 compared to an increase of $7 during the year ended December 31, 2012, while the unrecognized prior service cost decreased $75 during the years ended December 31, 2013 and 2012. These transactions were net of deferred income tax of $227 during the year ended December 31, 2013 and net of a deferred income tax benefit of $27 during the year ended December 31, 2012.

Because plan assets are held in a qualified trust, anticipated returns are not reduced for taxes. Further, solely for this purpose, the plan is assumed to continue in force and not terminate during the period during which assets are invested. However, consideration is given to the potential impact of current and future investment policy, cash flow into and out of the trust, and expenses (both investment and non-investment) typically paid from plan assets (to the extent such expenses are not explicitly estimated within periodic cost).

Asset Allocation

The plan's weighted-average asset allocations at December 31, 2013 and 2012, by asset category, are as follows:

	December 31,	
	2013	2012
Mutual Funds - Fixed Income	59%	60%
Mutual Funds - Equity	41%	40%
Cash and equivalents	0%	0%
Total	100%	100%

The trust fund is sufficiently diversified to maintain a reasonable level of risk without imprudently sacrificing return, with a targeted asset allocation of 50% fixed income and 50% equities. The Investment Manager selects investment fund managers with demonstrated experience and expertise, and funds with demonstrated historical performance, for the implementation of the Plan's investment strategy. The Investment Manager will consider both actively and passively managed investment strategies and will allocate funds across the asset classes to develop an efficient investment structure.

It is the responsibility of the Trustee to administer the investments of the trust within reasonable costs, being careful to avoid sacrificing quality. These costs include, but are not limited to, management and custodial fees, consulting fees, transaction costs and other administrative costs chargeable to the trust.

The investment strategy for plan assets is to provide allocation models with varying degrees of investment return and risk consistent with sound funding objectives and participant demographics utilizing various types of assets such as large cap stocks, S&P 500 index fund, small and mid cap stocks, cash equivalents and short term bonds. The performance goal for the investments of the plan is to exceed the investment benchmarks over the most recent 3 and 5 year periods while taking less risk than the market.

Note 8 – Pension plans (continued)

Plan investments are stated at fair value, which is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). The following table presents the fair value of the net assets, by asset category, at December 31, 2013 and 2012:

Description of Assets:	2013	2012
Mutual Funds / Equity	$ 1,408	$ 1,132
Mutual Funds / Fixed Income	2,055	1,694
Total plan assets	$ 3,463	$ 2,826

All of the plans assets are considered to be Level 1 assets, within the fair value hierarchy, as of December 31, 2013 and 2012. Level 1 assets are those with quoted prices in active markets for identical assets or liabilities.

Other disclosures for the year ended December 31, 2013 and 2012:

Change in benefit obligation

	2013	2012
Projected benefit obligation – beginning of year	$ 3,282	$ 3,046
Service cost	134	12
Interest cost	140	138
Actuarial (gain) / loss	(455)	218
Benefits paid	(30)	(132)
Projected benefit obligation – end of year	$ 3,071	$ 3,282

Change in plan assets

	2013	2012
Fair value of assets – beginning of the year	$ 2,826	$ 2,434
Actual return on plan assets	317	224
Employer contribution	350	300
Benefits paid	(30)	(132)
Fair value of assets – end of the year	$ 3,463	$ 2,826
Deferred asset (gain) loss	$ (113)	$ (53)

Note 8 – Pension plans (continued)

Funded status

	2013	2012
Projected benefit obligation – end of year	$ (3,071)	$ (3,282)
Fair value of assets – end of year	3,463	2,826
Funded status at the end of the year	$ 392	$ (456)

Other changes in plan assets and benefit obligations recognized in other comprehensive income:

	2013	2012
Net (gain) loss	$ (742)	$ 7
Amortization of prior service cost	75	75
Total amount recognized	$ (667)	$ 82

The following tables set forth the disclosures regarding the defined benefit plan:

Components of net periodic benefit costs

	2013	2012
Service cost	$ 134	$ 12
Interest cost	140	138
Expected return on plan assets	(204)	(171)
Net amortization of prior service cost	(75)	(75)
Recognized net actuarial loss	175	158
Net periodic benefit cost	$ 170	$ 62

Note 8 – Pension plans (continued)

The end of year weighted-average assumptions are:

	2013	2012
Discount rate used for net periodic pension cost	4.00%	4.50%
Discount rate used for disclosure	5.00%	4.00%
Expected return on plan assets	7.50%	7.50%
Rate of compensation increase	3.00%	3.00%
Rate of compensation increase for net periodic pension cost	3.00%	3.00%
Expected future interest crediting rate	3.00%	3.00%

Additional disclosure information

Accumulated benefit obligation, December 31, 2013	$ 3,071
Vested benefit obligation, December 31, 2013	$ 2,813

The projected benefit payments for the next ten years are as follows:

Year	Amount
2014	$ 103
2015	204
2016	107
2017	360
2018	93
2019 – 2023	1,723

401(k) plan

In addition to the defined benefit plan described above, the Bank also sponsors a 401(k) defined contribution plan. The Bank makes a matching contribution to the plan in the amount of 100% of the first 3% and 50% of the next 3% of the elective contributions made by the participants. Participants have the right to contribute up to the maximum allowed under section 401(g) of the Internal Revenue Code.

Effective January 1, 2012, the Bank made supplemental contributions to the 401(k) accounts of salaried employees with a minimum of 14 years credited service as of December 31, 2011. These supplemental contributions were made to help compensate for the projected loss of pension benefits for these employees due to the transition to the cash-balance defined benefit plan. The supplemental contribution will be paid at the end of each year from 2012 through 2018 in which the employee remains in a salaried status with a minimum of 1,000 hours of credited service for that year.

Note 8 – Pension plans (continued)

The Bank also made supplemental contributions to the 401(k) accounts of employees hired January 1, 2012 or later who were not eligible for participation in the cash-balance defined benefit plan. The supplemental contribution was equal to 2.0% of the employee salary and will be paid at the end of each year, beginning December 31, 2012. The Bank's expense for all 401(k) contributions totaled $198 for 2013 and $192 for 2012.

Note 9 - Income taxes

Income tax expense attributable to income before income tax expense is summarized as follows:

	December 31, 2013	December 31, 2012
Current federal income tax expense	$ 550	$ 605
Deferred federal income tax expense	11	65
Total	$ 561	$ 670

Income tax expense differed from amounts computed by applying the U.S. Federal income tax rate of 34% to income before income tax expense as a result of the following:

	December 31, 2013	December 31, 2012
Income tax expense at the statutory rate	$ 877	$ 904
Increase (reduction) in income tax expense resulting from		
Tax-exempt interest	(266)	(268)
Disallowance of interest expense	11	12
Bank-owned life insurance	(63)	(10)
Other	2	32
Total	$ 561	$ 670

Note 9 - Income taxes (continued)

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities are as follows:

	December 31	
	2013	2012
Deferred tax assets		
Loans, due to allowance for loan losses and net unearned fees	$ 120	$ 120
Other real estate, due to valuation allowances	54	40
Pension valuation adjustment	277	504
Net unrealized loss on available-for-sale securities	185	-
Other	130	87
Total gross deferred tax assets	766	751
Deferred tax liabilities		
Bank premises and equipment due to differences in depreciation	121	135
Prepaid pension, due to actual pension contribution in excess of accrual for financial reporting purposes	407	346
Net unrealized gain on available-for-sale securities	-	976
Loan costs	110	111
Total gross deferred tax liabilities	638	1,568
Net deferred tax asset (liability)	$ 128	$ (817)

The Bank has determined that a valuation allowance for the gross deferred tax asset is not necessary at December 31, 2013 and 2012, since the total gross deferred asset is expected to be realized.

The Bank did not recognize any interest or penalties related to income tax during the years ended December 31, 2013 and 2012, and did not accrue interest or penalties as of December 31, 2013 and 2012. The Bank does not have an accrual for uncertain tax positions as of December 31, 2013 and 2012, as deductions taken and benefits accrued are based on widely understood administrative practices and procedures and are based on clear and unambiguous tax law. Tax returns for all years 2010 and thereafter are subject to future examination by tax authorities.

Note 10 - Securities sold under repurchase agreements and time deposits

The Bank offers to its larger commercial customers a cash management service known as securities sold under repurchase agreements. The Bank currently offers two different types of repurchase accounts. The first type is a sweep account where the funds are invested overnight by a third-party vendor and settled on a daily basis. Customers select an investment fund from the vendor, and earnings are posted to the customer's account as dividends. These accounts are reflected on the Bank's records as two offsetting accounts with the net being the current pending transfer amount.

The second type is a cash management account administered by the Bank that pays a set interest rate determined by management. These accounts are secured by a pledge of the Bank's investments, which remain under management's control. The Bank had $2,368 and $4,135 outstanding in cash management accounts as of December 31, 2013 and 2012, respectively. The maximum month-end outstanding balances were $5,918 and $6,918 during 2013 and 2012, respectively, and the average outstanding balances were $4,799 and $4,548 during these periods.

At December 31, 2013, maturities of time deposits are scheduled as follows:

Year Ending	Amount
2014	$ 36,734
2015	14,577
2016	9,656
2017	5,242
2018	6,995
	$ 73,204

In the ordinary course of business, certain directors, executive officers, and their affiliates (collectively referred to as "related parties") of the Bank have maintained deposit accounts with the Bank. These deposits were opened on substantially the same terms, including interest rates for interest-bearing accounts, as those prevailing at the time for comparable transactions with other unaffiliated persons. Balances for these deposits as of December 31, 2013 were $1,771.

Note 11 - Dividend restrictions and capital requirements

The Bank is subject to certain regulatory restrictions pertaining to the amount of dividends that it may pay. The Federal Reserve restricts, without prior approval, the total dividend payments of a member bank in any calendar year to the bank's net income of that year, as defined, combined with its retained net income of the preceding two calendar years, less any required transfers to surplus. At December 31, 2013, retained earnings which are free of such restrictions amounted to approximately $3,616.

Note 11 - Dividend restrictions and capital requirements (continued)

The Bank is subject to various regulatory capital requirements administered by the federal and state banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Bank's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2013, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2013, the most recent notification from the Federal Reserve Bank of Richmond 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 total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following table. There are no conditions or events since that notification that management believes have changed the Bank's category.

The Bank's actual regulatory capital amounts and ratios are also presented in the table below.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2013						
Total capital (to risk-weighted assets)	$ 26,009	20.0%	$ 10,400	8.0%	$ 13,000	>10.0%
Tier 1 capital (to risk-weighted assets)	$ 25,316	19.5%	$ 5,200	4.0%	$ 7,800	>6.0%
Tier 1 capital (leverage) (to average assets)	$ 25,316	12.4%	$ 8,147	4.0%	$ 10,184	>5.0%

Note 11 - Dividend restrictions and capital requirements (continued)

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2012						
Total capital (to risk-weighted assets)	$ 24,759	19.2%	$ 10,321	8.0%	$ 12,902	>10.0%
Tier 1 capital (to risk-weighted assets)	$ 24,030	18.6%	$ 5,161	4.0%	$ 7,741	>6.0%
Tier 1 capital (leverage) (to average assets)	$ 24,030	12.0%	$ 8,006	4.0%	$ 10,007	>5.0%

Note 12 – Noninterest expense - Other operating expenses

Major items included in the other operating expenses component of noninterest expense are as follows:

	2013	2012
Office supplies	$ 96	$ 86
Data processing	509	436
Virginia franchise tax	176	172
Audit fees	84	85
Board expense	85	88
FDIC assessments	115	110
Marketing and advertising costs	22	20
Other	908	868
	$ 1,995	$ 1,865

Note 13 - Financial instruments with off-balance-sheet risk

The Bank is not a party to derivative financial instruments with off-balance-sheet risks such as futures, forwards, swaps and options. The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These instruments may involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheets. The contract amounts of these instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

Note 13 - Financial instruments with off-balance-sheet risk (continued)

Credit risk is defined as the possibility of sustaining a loss because the other party to a financial instrument fails to perform in accordance with the terms of the contract. The Bank's maximum exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of the instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

The Bank requires collateral or other security to support financial instruments when it is deemed necessary. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the counterparty and the Bank's access to the collateral. Types of collateral may include marketable securities, real estate and business equipment.

Financial instruments whose contract amounts represent credit risk are as follows:

	Contract Amounts at December 31	
	2013	2012
Commitments to extend credit	$ 15,950	$ 15,131
Standby letters of credit	$ 516	$ 784

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support private borrowing arrangements. The credit risk involved in issuing standby letters of credit is generally less than that involved in extending loans to customers because the Bank generally holds deposits equal to the commitment. Management does not anticipate any material losses as a result of these transactions.

The Bank's business activity is with customers located in the Counties of Appomattox, Buckingham, Campbell, and Prince Edward, Virginia. Accordingly, operating results are closely correlated with the economic trends within the counties and influenced by the significant industries within the region, including agriculture, timber and logging, and light manufacturing. In addition, the ultimate collectability of the Bank's loan portfolio is susceptible to changes in the market conditions within the region.

Note 14 - Disclosures about fair values of financial instruments

ASC 825, *Financial Instruments*, requires the Bank to disclose estimated fair values of its financial instruments.

The following methods and assumptions were used to estimate the approximate fair value of each class of financial instrument for which it is practicable to estimate fair value.

Cash and due from banks and federal funds sold

The carrying amount is a reasonable estimate of fair value due to the short investment duration.

Securities

The fair value of securities, except certain state and municipal instruments, is estimated based on bid prices published in financial newspapers or bid quotations received from securities dealers. The fair value of certain state and municipal securities is not readily available through market sources other than dealer quotations, so fair value estimates are based on quoted market prices of similar instruments, adjusted for differences between the quoted instruments and the instruments being valued.

Loans

Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by two types, namely residential real estate (variable rate) and other loans (predominantly fixed rate consumer and commercial.)

The fair value of loans is calculated by discounting scheduled cash flows for loans maturing after one year and through the estimated maturity using the average loan yield for the most recent quarter. The carrying amount of loans maturing within one year approximates their fair value. The estimate of maturity is based on actual loan maturity schedules for all types of loans.

Investment in bank-owned life insurance

Fair values of insurance policies owned are based on the insurance contract's cash surrender value.

Deposits

The fair values of noninterest-bearing demand deposits, interest-bearing demand deposits and savings deposits are equal to their carrying amounts since the amounts are payable on demand. The fair value of fixed maturity time deposits and certificates of deposit is estimated by discounting scheduled cash flows through maturity using the average time deposit yield for the most recent quarter.

Accrued interest receivable and accrued interest payable

The carrying amount of accrued interest receivable on the Bank's investment securities and loans is assumed to approximate fair value. Likewise, the carrying amount of accrued interest payable on the Bank's interest-bearing deposits is assumed to approximate fair value.

Note 14 - Disclosures about fair values of financial instruments (continued)

Securities sold under repurchase agreements

The carrying amount is a reasonable estimate of fair value.

Commitments to extend credit and standby letters of credit

The only amounts recorded for commitments to extend credit and standby letters of credit are the fees arising from these unrecognized financial instruments. These fees were minimal at December 31, 2013 and 2012, and as such, the related fair values have not been estimated.

The carrying amounts and approximate fair values of the Bank's financial instruments are summarized as follows:

	December 31, 2013		December 31, 2012	
	Carrying Amounts	Approximate Fair Values	Carrying Amounts	Approximate Fair Values
Financial assets				
Cash and due from banks	$ 3,535	$ 3,535	$ 4,403	$ 4,403
Federal funds sold	256	256	581	581
Securities				
Available-for-sale	54,703	54,703	49,950	49,950
Held to maturity	12,374	13,094	15,641	16,880
Loans, net	119,549	110,228	118,022	109,516
Accrued interest receivable	1,129	1,129	1,144	1,144
Investment in bank-owned life insurance	5,215	5,215	5,030	5,030
Total financial assets	$ 196,761	$ 188,160	$ 194,771	$ 187,504
Financial liabilities				
Deposits	$ 174,003	$ 173,512	$ 169,021	$ 168,432
Securities sold under repurchase agreements	2,400	2,400	4,120	4,120
Accrued interest payable	126	126	149	149
Total financial liabilities	$ 176,529	$ 176,038	$ 173,290	$ 172,701

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Bank's entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Bank's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment, and therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Note 14 - Disclosures about fair values of financial instruments (continued)

Fair value estimates are based on existing on-balance-sheet and off-balance-sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Significant assets that are not considered financial instruments include bank premises and equipment, and intangible assets; significant liabilities that are not considered financial instruments are accrued pension expense and the deferred income tax liability. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in the estimates.

Note 15 – Fair Value Measurements

ASC 820, *Fair Value Measurements and Disclosures*, provides a framework for measuring fair value under generally accepted accounting principles (GAAP) and enhances disclosures about fair value measurements. ASC 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. When measuring fair value, valuation techniques should be appropriate in the circumstances and consistently applied. A hierarchy is used to prioritize valuation inputs into the following three levels to determine fair value:

- Level 1 – quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 – observable inputs other than the quoted prices included in Level 1.
- Level 3 – unobservable inputs.

Assets measured at fair value on a recurring basis, including financial instruments for which the Bank has elected the fair value option, are summarized below. The Bank has not elected the fair value option to value liabilities.

Investment Securities Available-for-Sale
Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets.

Loans
The Bank does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with ASC 310, *Receivables*. The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans.

Note 15 – Fair Value Measurements (continued)

Loans (continued)
At December 31, 2013, substantially all of the total impaired loans were evaluated based on the fair value of the collateral. In accordance with ASC 820, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Bank records the impaired loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Bank records the impaired loan as nonrecurring Level 3. Appraised values may be discounted to reflect current market conditions and ultimate collectability. These discounts typically ranged from 0% to 10% for each of the respective periods.

Other Real Estate Owned
Real estate acquired primarily through foreclosure is transferred to other real estate owned ("OREO"). The measurement of loss associated with OREO is based on the fair value of the collateral compared to the unpaid loan balance and anticipated costs to sell the property. The value of OREO collateral is determined utilizing an income or market valuation approach based on an appraisal conducted by an independent, licensed appraiser outside of the Bank using observable market data (Level 2). However, if the collateral is a house or building in the process of construction or if an appraisal of the real estate is over one year old, then the fair value is considered Level 3. Any fair value adjustments are recorded in the period incurred and expensed against current earnings. Appraised values may be discounted to reflect current market conditions and ultimate collectability. These discounts typically ranged from 0% to 10% for each of the respective periods.

The following table summarizes quantitative disclosures about the fair value measurement for each category of assets carried at fair value as of December 31, 2013 and 2012, on a recurring or nonrecurring basis:

Description	Fair Value of Asset	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Recurring Basis:				
December 31, 2013				
Securities, Available-for-sale	$ 54,703	$ 8,563	$ 46,140	$ -
December 31, 2012				
Securities, Available-for-sale	$ 49,950	$ 7,136	$ 42,814	$ -
Non-recurring Basis:				
December 31, 2013				
Impaired loans	$ 101	$ -	$ -	$ 101
Other real estate owned	$ 697	$ -	$ -	$ 697
December 31, 2012				
Impaired loans	$ 169	$ -	$ -	$ 169
Other real estate owned	$ 1,289	$ -	$ -	$ 1,289

Note 16 – Subsequent Events

Management has evaluated subsequent events for potential recognition and/or disclosure in the December 31, 2013 consolidated financial statements. This evaluation was through March 14, 2014, the date the consolidated financial statements were available to be issued. Management noted that on January 14, 2014, the Board of Directors declared a dividend of $0.40 per share payable January 31, 2014 to shareholders of record as of January 21, 2014.

BOARD OF DIRECTORS



L-R standing: Benjamin H. Johnson, Thomas D. Evans, Luther C. Thomas, Douglas M. Webb, R. Kinckle Robinson, Watkins M. Abbitt Jr.; L-R seated: Laurie S. Harris, Ronald C. Spiggle, John R. Caldwell, Floyd E. Williams

Watkins M. Abbitt,, Jr.
Retired President, Conner Insurance Agency
Retired Member - Virginia House of Delegates

John R. Caldwell
President and Chief Executive Officer

Thomas D. Evans, Jr.
Pharmacist, CVS

Laurie S. Harris
Manager, Risk & Treasury Services,
Areva Enterprises Inc.

Benjamin H. Johnson
Self-employed, Certified Public Accountant

R. Kinckle Robinson
President,
Robinson Funeral Home, Inc.

Ronald C. Spiggle
Chairman of the Board
Vice President,
Robinson Funeral Home, Inc.

Luther C. Thomas
Owner,
Thomas Insurance Agerncy

Douglas M. Webb
President,
Webb Tire Company, Inc.

Floyd E. Williams
Bank President, Retired

EXECUTIVE OFFICERS



L-R: Jane H. Kelly, Bruce S. Drinkard, Dawn S. Tolley, John R. Caldwell, Michael F. Ledin

John R. Caldwell
President & Chief Executive Officer

Bruce S. Drinkard
Senior Vice President & Chief Lending Officer

Jane H. Kelly
Senior Vice President & Chief Operations Officer

Michael F. Ledin
Senior Vice President & Chief Compliance Officer

Dawn S. Tolley
Senior Vice President & Chief Financial Officer

MAIN STREET OFFICERS



Standing L-R: Thomas R. Cobb, Kris McFadden, Thomas L. Rasey, Jr., Linda F. Sears, Kenneth A. Shorter; Seated L-R: Jodi C. Simpson, Leila A. Paulette



Standing L-R: Katherine A. Kraince, Jane A. Thomas, Sandra L. Clapp; Seated L-R: Betty G. Craft, Robin B. Harvey

BUCKINGHAM



Lisa H. Warner, Stephanie L. Oliver

FARMVILLE



Janet L. King, James E. Duff, Jr.

CONCORD



Brian D. Wilkerson, Christopher R. Lewis

TRIANGLE PLAZA



Sarah E. Overstreet, Diane R. Rudder

EMPLOYEES

MAIN OFFICE

Joseph Almond
Janet Baker
Morgan Barksdale
James Bollinger
Anna Christie
Will Coleman
Whitney Drew
Dorothy Evans
Wanda Evans
Dylan Fanney
Penny Franklin
Sue Fulcher
Charlotte Gillian
Curtis Hancock
Kaitlyn Hopkins
Joan Jamerson
Karen Lawson
Uwana Litchford
Jimmy Mayberry
Barbara Moore
Marty Moore
Gwen Phelps
Sue Ranson
Cassandra Reed
Samantha Sauers
Kelly Smith
Sonny Smith
Tommy Stanley
Mary Sue Stanley
Mary Staples
Keelyn Wheeler
Samantha Williams
Lynn Wilmoth

TRIANGLE PLAZA BRANCH

Tara Almond
Del Chambers
Sarah Jones
Cindy Mayberry
Betty Pollard

CONCORD BRANCH

Hope Bondurant
Candy Burrell
Sue Doss
Connie French
Doris Tyree

BUCKINGHAM BRANCH

Beverly Jo DeVore
Kara Kitchen
Sherri Martin
Jackie Murphy
Stacy Shumaker

FARMVILLE BRANCH

Judy Bolt
Jessica Hall
Lucretia Holman
Danielle Scruggs
Taylor Webster

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