# RIVER VALLEY COMMUNITY BANK

## FINANCIAL STATEMENTS

December 31, 2011 and 2010

Crowe Horwath.

**Crowe Horwath LLP**
Independent Member Crowe Horwath International

# REPORT OF INDEPENDENT AUDITORS

The Shareholders and
Board of Directors
River Valley Community Bank
Yuba City, California

We have audited the accompanying balance sheet of River Valley Community Bank as of December 31, 2011 and the related statements of income, changes in shareholders' equity and cash flows for the year then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit. The 2010 financial statements of River Valley Community Bank were audited by Perry-Smith LLP, who combined with Crowe Horwath LLP as of November 1, 2011, and whose report dated March 15, 2011 expressed an unqualified opinion on those financial statements.

We conducted our audit 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 2011 financial statements referred to above present fairly, in all material respects, the financial position of River Valley Community Bank as of December 31, 2011 and the results of its operations and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Crowe Horwath LLP

Crowe Horwath LLP

Sacramento, California
March 20, 2012

RIVER VALLEY COMMUNITY BANK
BALANCE SHEETS
December 31, 2011 and 2010

| | 2011 | 2010 |
|---|---|---|
| **ASSETS** | | |
| Cash and due from banks | $ 5,689,203 | $ 4,299,235 |
| Federal funds sold | 10,177,870 | 19,214,838 |
| Total cash and cash equivalents | 15,867,073 | 23,514,073 |
| Interest-bearing deposits in other banks | 1,245,000 | 747,000 |
| Available-for-sale investment securities (Note 2) | 73,503,969 | 64,801,749 |
| Loans, less allowance for loan losses of $1,593,570 in 2011 and $1,438,518 in 2010 (Notes 3, 8 and 11) | 45,330,861 | 42,022,373 |
| Premises and equipment, net (Note 4) | 2,231,846 | 2,252,405 |
| Accrued interest receivable and other assets | 2,356,740 | 2,832,600 |
| | $ 140,535,489 | $ 136,170,200 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| Deposits: | | |
| Non-interest bearing | $ 32,738,065 | $ 26,514,715 |
| Interest bearing (Note 5) | 88,422,135 | 92,896,193 |
| Total deposits | 121,160,200 | 119,410,908 |
| Accrued interest payable and other liabilities | 1,057,244 | 435,414 |
| Total liabilities | 122,217,444 | 119,846,322 |
| Commitments and contingencies (Note 8) | | |
| Shareholders' equity (Notes 9 and 10): | | |
| Preferred stock – no par value; 5,000,000 shares authorized, none outstanding | - | - |
| Common stock – no par value; 50,000,000 shares authorized; issued and outstanding – 1,716,935 shares in 2011 and 1,716,785 in 2010 | 14,311,302 | 14,198,837 |
| Retained earnings | 2,762,209 | 1,505,964 |
| Accumulated other comprehensive income, net (Note 2) | 1,244,534 | 619,077 |
| Total shareholders' equity | 18,318,045 | 16,323,878 |
| Total liabilities and shareholders' equity | $ 140,535,489 | $ 136,170,200 |

See accompanying notes to financial statements.

RIVER VALLEY COMMUNITY BANK
STATEMENTS OF INCOME
Years Ended December 31, 2011 and 2010

| | 2011 | 2010 |
|---|---|---|
| Interest income: | | |
| Interest and fees on loans | $ 2,606,736 | $ 2,547,301 |
| Interest on Federal funds sold | 22,672 | 21,887 |
| Interest on certificates of deposit with other banks | 28,968 | 9,539 |
| Interest on investment securities | | |
| Taxable | 1,915,620 | 1,915,804 |
| Exempt from Federal income taxes | 485,729 | 364,994 |
| Total interest income | 5,059,725 | 4,859,525 |
| Interest expense: | | |
| Interest on deposits (Note 5) | 445,979 | 598,926 |
| Net interest income | 4,613,746 | 4,260,599 |
| Provision for loan losses (Note 3) | 190,000 | 600,000 |
| Net interest income after provision for loan losses | 4,423,746 | 3,660,599 |
| Non-interest income: | | |
| Service charges and fees | 163,782 | 138,395 |
| Gain on sale of investments (Note 2) | 53,232 | 98,552 |
| Other | 13,563 | 17,653 |
| Total non-interest income | 230,577 | 254,600 |
| Non-interest expense: | | |
| Salaries and employee benefits (Notes 9 and 12) | 1,659,079 | 1,421,338 |
| Occupancy and equipment (Note 4) | 214,785 | 171,753 |
| Data processing | 226,668 | 212,947 |
| FDIC insurance and assessments | 193,785 | 188,481 |
| Professional fees | 116,573 | 117,179 |
| Other | 401,844 | 392,657 |
| Total non-interest expense | 2,812,734 | 2,504,355 |
| Net income before provision for income taxes | 1,841,589 | 1,410,844 |
| Provision for income taxes (Note 7) | 585,344 | 368,721 |
| Net income | $ 1,256,245 | $ 1,042,123 |
| Basic income per share | $ 0.73 | $ 0.61 |
| Diluted income per share | $ 0.71 | $ 0.58 |

See accompanying notes to financial statements.

RIVER VALLEY COMMUNITY BANK
STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Years Ended December 31, 2011 and 2010

| | Common Stock | | | Accum-ulated Other Compre-hensive Income, Net | Total Share-holders' Equity | Compre-hensive Income |
|---|---|---|---|---|---|---|
| | Shares | Amount | Retained Earnings | | | |
| Balance, January 1, 2010 | 1,715,360 | $ 14,106,842 | $ 463,841 | $ 872,106 | $ 15,442,789 | |
| Net income | | | 1,042,123 | | 1,042,123 | $ 1,042,123 |
| Other comprehensive income: | | | | | | |
| Change in unrealized gain on available-for-sale investment securities, net of taxes (Note 2) | | | | (253,029) | (253,029) | (253,029) |
| Exercise of stock options | 1,425 | 12,857 | | | 12,857 | |
| Fractional share cost of 5 for 4 stock split | | (206) | | | (206) | |
| Total comprehensive income | | | | | | $ 789,094 |
| Share-based payments (Note 10) | | 79,344 | | | 79,344 | |
| Balance, December 31, 2010 | 1,716,785 | 14,198,837 | 1,505,964 | 619,077 | 16,323,878 | |
| Net income | | | 1,256,245 | | 1,256,245 | $ 1,256,245 |
| Other comprehensive income: | | | | | | |
| Change in unrealized gain on available-for-sale investment securities, net of taxes (Note 2) | | | | 625,457 | 625,457 | 625,457 |
| Exercise of stock options | 150 | 1,321 | | | 1,321 | |
| Total comprehensive income | | | | | | $ 1,881,702 |
| Share-based payments (Note 10) | | 111,144 | | | 111,144 | |
| Balance, December 31, 2011 | 1,716,935 | $ 14,311,302 | $ 2,762,209 | $ 1,244,534 | $ 18,318,045 | |

See accompanying notes to financial statements.

RIVER VALLEY COMMUNITY BANK
STATEMENTS OF CASH FLOWS
Years Ended December 31, 2011 and 2010

| | 2011 | 2010 |
|---|---|---|
| **Cash flows from operating activities:** | | |
| Net income | $ 1,256,245 | $ 1,042,123 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Provision for loan losses | 190,000 | 600,000 |
| Depreciation, amortization and accretion | 566,244 | 296,301 |
| Gain on sale of available-for-sale investment securities | (53,232) | (98,552) |
| Loss on sale of other real estate owned | 1,365 | |
| Net increase (decrease) in deferred loan fees | 36,197 | (16,855) |
| Deferred income tax benefit | (16,700) | (293,900) |
| Share-based payments | 111,144 | 79,344 |
| Net (increase) decrease in accrued interest receivable and other assets | (581,812) | (285,661) |
| Net increase (decrease) in accrued interest payable and other liabilities | 621,830 | (211,923) |
| Net cash provided by operating activities | 2,131,281 | 1,698,677 |
| **Cash flows from investing activities:** | | |
| Net (increase) decrease in interest-bearing deposits in other banks | (498,000) | 1,236,000 |
| Purchases of available-for-sale investment securities | (46,279,454) | (37,403,876) |
| Proceeds from maturities and calls of available-for-sale investment securities | 1,250,000 | 4,161,767 |
| Proceeds from principle payments on available-for-sale investment securities | 16,643,744 | 10,346,325 |
| Proceeds from sales of available-for-sale investment securities | 20,303,547 | 9,003,005 |
| Proceeds from sale of other real estate owned | 206,035 | |
| Net (increase) decrease in loans | (3,084,685) | 983,040 |
| Purchase of premises and equipment | (70,081) | (18,304) |
| Net cash used in investing activities | (11,528,894) | (11,692,043) |
| **Cash flows from financing activities:** | | |
| Demand, interest bearing and savings deposits, net | 258,586 | 30,829,736 |
| Time deposits, net | 1,490,706 | (4,789,078) |
| Proceeds from exercise of stock options | 1,321 | 12,857 |
| Repurchase of fractional shares | | (206) |
| Net cash provided by financing activities | 1,750,613 | 26,053,309 |
| (Decrease) increase in cash and cash equivalents | (7,647,000) | 16,059,943 |
| Cash and cash equivalents at beginning of period | 23,514,073 | 7,454,130 |
| **Cash and cash equivalents at end of year** | $ 15,867,073 | $ 23,514,073 |

(Continued)

RIVER VALLEY COMMUNITY BANK
STATEMENTS OF CASH FLOWS
Years Ended December 31, 2011 and 2010

| | 2011 | 2010 |
|---|---|---|
| Supplemental cash flow information: | | |
| Interest paid | $ 446,001 | $ 618,191 |
| Income taxes paid | $ 611,000 | $ 530,000 |
| Supplemental noncash disclosures: | | |
| Transfers from loans to OREO | | $ 657,400 |
| Loans provided for sales of OREO | $ 450,000 | |

See accompanying notes to financial statements.

## NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General: River Valley Community Bank (the "Bank") was approved as a state-chartered non-member bank on December 27, 2005 and is subject to regulation by the California Department of Financial Institutions (the "DFI") and the Federal Deposit Insurance Corporation (the "FDIC"). The Bank's deposits are insured by the FDIC up to applicable legal limits. The Bank is headquartered in Yuba City, California and provides products and services to customers who are predominately small to middle-market businesses, professionals and not-for-profit organizations located in Sutter, Yuba and surrounding counties.

The accounting and reporting policies of the Bank conform with accounting principles generally accepted in the United States of America and prevailing practices within the banking industry.

Use of Estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. The allowance for loan losses, deferred tax assets and the fair value of financial instruments are particularly subject to change.

Cash and Cash Equivalents: For the purpose of the statement of cash flows, cash and cash equivalents consist of cash and due from banks and Federal funds sold. Generally, Federal funds are sold for one day periods.

Interest-Bearing Deposits in Other Banks: Interest-bearing deposits in banks mature within four to eight years and are carried at cost.

Federal Home Loan Bank (FHLB) Stock: The Bank is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock in included in accrued interest receivable and other assets on the balance sheet and is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

Investment Securities: Investments are classified into the following categories:

Available-for-sale securities reported at fair value, with unrealized gains and losses excluded from earnings and reported, net of taxes, as accumulated other comprehensive income (loss) within shareholders' equity.

Held-to-maturity securities, which management has the positive intent and ability to hold, reported at amortized cost, adjusted for the accretion of discounts and amortization of premiums.

Management determines the appropriate classification of its investments at the time of purchase and may only change the classification in certain limited circumstances. All transfers between categories are accounted for at fair value. As of December 31, 2011 and 2010, all of the Bank's investments were classified as available-for-sale and there were no transfers between categories.

Gains or losses on the sale of investment securities are computed on the specific identification method. Interest earned on investment securities is reported in interest income, net of applicable adjustments for accretion of discounts and amortization of premiums.

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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

An investment security is impaired when its carrying value is greater than its fair value. Investment securities that are impaired are evaluated on at least a quarterly basis and more frequently when economic or market conditions warrant such an evaluation to determine whether such a decline in their fair value is other than temporary. Management utilizes criteria such as the magnitude and duration of the decline and the intent and ability of the Bank to retain its investment in the securities for a period of time sufficient to allow for an anticipated recovery in fair value, in addition to the reasons underlying the decline, to determine whether the loss in value is other than temporary. The term "other than temporary" is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Once a decline in value is determined to be other than temporary, and management does not intend to sell the security or it is more likely than not that the Bank will not be required to sell the security before recovery, only the portion of the impairment loss representing credit exposure is recognized as a charge to earnings, with the balance recognized as a charge to other comprehensive income. If management intends to sell the security or it is more likely than not that the Bank will be required to sell the security before recovering its forecasted cost, the entire impairment loss is recognized as a charge to earnings.

Loans: Loans are stated at principal balances outstanding. Interest is accrued daily based upon outstanding loan balances. However, when, in the opinion of management, loans are considered to be impaired and the future collectibility of interest and principal is in serious doubt, loans are placed on nonaccrual status and the accrual of interest income is suspended. Any interest accrued but unpaid is charged against income. Payments received are applied to reduce principal to the extent necessary to ensure collection. Subsequent payments on these loans, or payments received on nonaccrual loans for which the ultimate collectibility of principal is not in doubt, are applied first to earned but unpaid interest and then to principal.

All material loan origination fees, commitment fees, direct loan origination costs and purchase premiums and discounts on loans are deferred and recognized as an adjustment of yield, to be amortized to interest income over the contractual term of the loan. Salaries and employee benefits totaling $76,585 and $67,542 have been deferred as direct loan origination costs for the years ended December 31, 2011 and 2010, respectively.

Allowance for Loan Losses: The allowance for loan losses is an estimate of probable credit losses inherent in the Bank's loan portfolio that have been incurred as of the balance-sheet date. The allowance is established through a provision for loan losses which is charged to expense. Additions to the allowance are expected to maintain the adequacy of the total allowance after credit losses and loan growth. Credit exposures determined to be uncollectible are charged against the allowance. Cash received on previously charged off amounts is recorded as a recovery to the allowance. The overall allowance consists of two primary components, specific reserves related to impaired loans and general reserves for inherent losses related to loans that are collectively reviewed for impairment.

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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the original agreement. Loans determined to be impaired are individually evaluated for impairment. When a loan is impaired, the Bank measures impairment based on the present value of expected future cash flows discounted at the loan's effective interest rate, except that as a practical expedient, it may measure impairment based on a loan's observable market price, or the fair value of the collateral if the loan is collateral dependent. A loan is collateral dependent if the repayment of the loan is expected to be provided solely by the underlying collateral.

A restructuring of a debt constitutes a troubled debt restructuring (TDR) if the Bank for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. Restructured workout loans typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. Loans that are reported as TDRs are considered impaired and measured for impairment as described above.

The determination of the general reserve for loans that are collectively evaluated for impairment is based on estimates made by management, to include, but not limited to, consideration of historical losses by portfolio segment, internal asset classifications, and qualitative factors to include economic trends in the Bank's service areas, industry experience and trends, geographic concentrations, estimated collateral values, the Bank's underwriting policies, the character of the loan portfolio, and probable losses inherent in the portfolio taken as a whole.

The Bank determines a separate allowance for each portfolio segment. These portfolio segments include agriculture, commercial, commercial real estate, real estate – other, and consumer loans. The allowance for loan losses attributable to each portfolio segment, which includes both impaired loans and loans that are collectively evaluated for impairment, is combined to determine the Bank's overall allowance, which is included on the balance sheet.

The Bank assigns a risk rating to all loans and periodically performs detailed reviews of all such loans over a certain threshold to identify credit risks and to assess the overall collectability of the portfolio. These risk ratings are also subject to examination by independent specialists engaged by the Bank and the Bank's regulators. During these internal reviews, management monitors and analyzes the financial condition of borrowers and guarantors, trends in the industries in which borrowers operate and the fair values of collateral securing these loans. These credit quality indicators are used to assign a risk rating to each individual loan. The risk ratings can be grouped into five major categories, defined as follows:

*Pass* – A pass loan is a strong credit with no existing or known potential weaknesses deserving of management's close attention.

*Special Mention* – A special mention loan has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or in the Bank's credit position at some future date. Special Mention loans are not adversely classified and do not expose the Bank to sufficient risk to warrant adverse classification.

*Substandard* – A substandard loan is not adequately protected by the current sound worth and paying capacity of the borrower or the value of the collateral pledged, if any. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Well defined weaknesses include a project's lack of marketability, inadequate cash flow or collateral support, failure to complete construction on time or the project's failure to fulfill economic expectations. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

*Doubtful* – Loans classified doubtful have all 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 currently known facts, conditions and values, highly questionable and improbable.

*Loss* – Loans classified as loss are considered uncollectible and charged off immediately.

The general reserve component of the allowance for loan losses also consists of reserve factors that are based on management's assessment of the following for each portfolio segment: (1) inherent credit risk, (2) historical losses and (3) other qualitative factors. These reserve factors are inherently subjective and are driven by the repayment risk associated with each portfolio segment described below.

*Agriculture* – Loans secured by crop production and livestock are especially vulnerable to two risk factors that are largely outside the control of Bank and borrowers: commodity prices and weather conditions.

*Commercial* – Commercial loans generally possess a lower inherent risk of loss than real estate portfolio segments because these loans are generally underwritten to existing cash flows of operating businesses. Debt coverage is provided by business cash flows and economic trends influenced by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans.

*Commercial real estate* – These loans include acquisition and development, commercial non-owner occupied and construction loans. Commercial real estate loans generally possess a higher inherent risk of loss than other real estate portfolio segments, except land and construction loans. A major risk arises for acquisition and development as well as construction loans from the necessity to complete projects within specified cost and time lines. Adverse economic developments or an overbuilt market impact commercial real estate projects and may result in troubled loans. Trends in vacancy rates of commercial properties impact the credit quality of these loans. High vacancy rates reduce operating revenues and the ability for properties to produce sufficient cash flow to service debt obligations.

*Real estate – other* – These loans include all loans secured by real estate directly utilized or occupied by the borrower or related entity. They include agricultural land, commercial owner occupied, home equity lines of credit, residential non-owner occupied, residential construction and residential owner occupied real estate loans. These loans typically carry lower risk than those classified as commercial real estate as they are closely tied to the owners and occupants that are servicing the debt. These loans are, however, subject to the same adverse collateral trends that can negatively impact the credit quality as they are typically relied upon as secondary sources of repayment.

*Consumer* – Loans made to individuals to provide personal purchases for household and equipment items are impacted by trends in unemployment and income levels. General economic activity and concentrations in various job markets could adversely impact this segment given the loss or relocation of a major employer.

Although management believes the allowance to be adequate, ultimate losses may vary from its estimates. At least quarterly, the Board of Directors and management reviews the adequacy of the allowance, including consideration of the relative risks in the portfolio, current economic conditions and other factors. If the Board of Directors and management determine that changes are warranted based on those reviews, the allowance is adjusted. In addition, the Bank's primary regulators, the FDIC and the California Department of Financial Institutions, as an integral part of their examination process, review the adequacy of the allowance. These regulatory agencies may require additions to the allowance based on their judgment about information available at the time of their examinations.

(Continued)

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Allowance for Credit Losses on Off-Balance-Sheet Credit Exposures: The Bank also maintains a separate allowance for off-balance-sheet commitments. Management estimates anticipated losses using historical data and utilization assumptions. The allowance for off-balance-sheet commitments is included in accrued interest payable and other liabilities on the balance sheet and is not significant.

Other Real Estate Owned: Other real estate owned (OREO) is comprised of property acquired through foreclosure proceedings or acceptance of deeds-in-lieu of foreclosure. Losses recognized at the time of acquiring property in full or partial satisfaction of debt are charged against the allowance for loan losses. OREO is initially recorded at fair value less estimated disposition costs. Fair value of OREO is generally based on an independent appraisal of the property. Subsequent to initial measurement, OREO is carried at the lower of the recorded investment or fair value less costs to sell. Revenues and expenses associated with OREO, and subsequent adjustment to the fair value of the property and to the estimated costs of disposal, are realized and reported as a component of noninterest expense when incurred. OREO is reported as a component of other assets on the balance sheet.

The Bank had no OREO properties at December 31, 2011. At December 31, 2010, the Bank had $657,400 invested in one property acquired through foreclosure. This property was carried at its fair value based on a third-party appraisal and is included in other assets on the balance sheet.

Premises and Equipment: Premises and equipment are carried at cost. Depreciation is determined using the straight-line method over the estimated useful lives of the related assets. The useful lives of premises are estimated to be 15 to 39 years. The useful lives of furniture, fixtures and equipment are estimated to be 3 to 10 years.

When assets are sold or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to expense as incurred. The Bank evaluates premises and equipment for financial impairment as events or changes in circumstances indicate that the carrying amount of such assets may not be fully recoverable.

Income Taxes: Deferred tax assets and liabilities are recognized for the tax consequences of temporary differences between the reported amount of assets and liabilities and their tax basis. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. A valuation allowance is recognized if, based on the weight of available evidence, management believes it is more likely than not that some portion or all of the deferred tax assets will not be realized.

The Bank uses a comprehensive model for recognizing, measuring, presenting and disclosing in the financial statements tax positions taken or expected to be taken on a tax return. A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded.

Interest and penalties associated with unrecognized tax benefits are classified as income tax expense in the statement of operations.

(Continued)

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Earnings Per Share: Basic earnings per share (EPS), which excludes dilution, is computed by dividing net income by the weighted-average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options, result in the issuance of common stock which shares in the earnings of the Bank. The treasury stock method is applied to determine the dilutive effect of stock options in computing diluted earnings per share. Earnings per share is retroactively adjusted for stock dividends and stock splits for all periods presented.

Stock-Based Compensation: Compensation cost is recognized for stock options and restricted stock awards issued to employees, based on the fair value of these awards at the date of grant. A Black-Scholes model is utilized to estimate the fair value of stock options, while the market price of the Bank's common stock at the date of grant is used for restricted stock awards.

Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award.

Comprehensive Income: Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on securities available for sale which are also recognized as separate components of equity.

Loss Contingencies: Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there now are such matters that will have a material effect on the financial statements.

Fair Value of Financial Instruments: Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect these estimates.

Subsequent Events: The Bank reviewed all events occurring from December 31, 2011 through March 20, 2012, the date the financial statements were available to be issued and no subsequent events occurred requiring accrual or disclosure.

Adoption of New Financial Accounting Standards

In July 2010, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update (ASU) 2010-20, *Receivables* ("Topic 310") – *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses ("ASU 10-20")*. ASU 10-20 requires a company to disaggregate the new and existing disclosures based on how it develops its allowance for credit losses and how it manages credit exposures. Short-term accounts receivable, receivables measured at fair value or lower of cost or fair value, and debt securities are exempt from the ASU 10-20. For public companies, the amendments that require disclosures as of the end of a reporting period were effective for periods ending on or after December 15, 2010. The adoption of this portion of ASU 10-20 did not have a material impact on the Bank's financial position, results of operations, or cash flows. The amendments that require disclosures about activity that occurs during a reporting period were effective for periods beginning on or after December 15, 2010. In addition, disclosures related to troubled debt restructurings were effective for periods beginning on or after July 1, 2011. The adoption of these portions of the ASU did not have a material impact on the Bank's financial position, results of operations, or cash flows.

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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

In April 2011, the FASB issued ASU 2011-02, *Receivables ("Topic 310") – A Creditors Determination of Whether a Restructuring Is a Troubled Debt Restructuring*. This ASU amends the content in ASC 310 related to identifying TDRs. This ASU removes the deferral of the TDR disclosure requirements of ASU 2010-20 for public entities and thus establishes the effective date for those disclosures. ASU 11-02 is effective for the first interim or annual period beginning on or after June 15, 2011, and is to be applied retrospectively to modifications occurring on or after the beginning of the fiscal year of adoption. The Bank adopted the provisions of ASU 11-02 on July 1, 2011. The adoption of this ASU did not have a material impact on the Bank's financial position, results of operations, or cash flows.

**NOTE 2 – AVAILABLE-FOR-SALE INVESTMENT SECURITIES**

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2011 and 2010 consisted of the following:

| | 2011 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| Debt securities: | | | | |
| U.S. Government sponsored entities and agencies | $ 2,422,611 | $ 145,417 | | $ 2,568,028 |
| Obligations of states and political subdivisions | 14,243,456 | 1,024,779 | $ (7,257) | 15,260,978 |
| U.S. Government sponsored entities and agencies collateralized by mortgage obligations | 12,422,648 | 98,945 | (43,648) | 12,477,945 |
| Residential mortgage-backed securities | 35,593,081 | 993,781 | (22,072) | 36,564,790 |
| Other debt securities | 6,747,949 | 158,194 | (273,915) | 6,632,228 |
| | $ 71,429,745 | $ 2,421,116 | $ (346,892) | $ 73,503,969 |

| | 2010 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| Debt securities: | | | | |
| U.S. Government sponsored entities and agencies | $ 2,597,658 | $ 56,461 | $ (11,271) | $ 2,642,848 |
| Obligations of states and political subdivisions | 11,119,282 | 84,554 | (90,768) | 11,113,068 |
| U.S. Government sponsored entities and agencies collateralized by mortgage obligations | 14,294,749 | 318,555 | (14,684) | 14,598,620 |
| Residential mortgage-backed securities | 27,773,521 | 706,908 | (210,051) | 28,270,378 |
| Other debt securities | 7,984,744 | 272,386 | (80,295) | 8,176,835 |
| | $ 63,769,954 | $ 1,438,864 | $ (407,069) | $ 64,801,749 |

(Continued)

**NOTE 2 – AVAILABLE-FOR-SALE INVESTMENT SECURITIES** (Continued)

Net unrealized gains on available-for-sale investment securities totaling $2,074,224 and $1,031,795 are recorded, net of $829,690 and $412,718 in tax liabilities as accumulated other comprehensive income within shareholders' equity at December 31, 2011 and 2010, respectively.

Proceeds and gross realized gains on the sale of investment securities available for sale were $20,303,547 and $53,232, respectively, for the year ended December 31, 2011. Proceeds and gross realized gains on the sale of investment securities available for sale were $9,003,005 and $98,552, respectively, for the year ended December 31, 2010.

The following table summarizes securities with unrealized losses at December 31, 2011, aggregated by major security type and length of time in a continuous unrealized loss position:

| | Less Than 12 Months | | 12 Months or Longer | | Total | |
|---|---|---|---|---|---|---|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| December 31, 2011 | | | | | | |
| Available-for-sale: | | | | | | |
| U.S. Government sponsored entities and agencies collateralized by mortgage obligations | $7,120,233 | $ (43,648) | | | $ 7,120,233 | $ (43,648) |
| Obligations of states and political subdivisions | 525,255 | (7,257) | | | 525,255 | (7,257) |
| Mortgage-backed securities – residential | 1,031,381 | (876) | $1,925,738 | $ (21,196) | 2,957,119 | (22,072) |
| Other debt securities | 490,195 | (9,805) | 3,735,890 | (264,110) | 4,226,085 | (273,915) |
| Total available-for-sale | $9,167,064 | $ (61,586) | $5,661,628 | $ (285,306) | $ 14,828,692 | $ (346,892) |

As of December 31, 2011, the Bank's security portfolio consisted of 74 securities, 14 of which were in an unrealized loss position. The majority of unrealized losses are related to the Bank's other debt securities, which are primarily corporate bonds.

Of the $285,306 total unrealized losses greater than 12 months, $273,915 relate to four corporate bonds.

Unrealized losses on corporate bonds have not been recognized into income because the issuers bonds are of high credit quality (rated Baa or higher), management does not intend to sell and it is likely that management will not be required to sell the securities prior to their anticipated recovery, and the decline in fair value is largely due to changes in interest rates and other market conditions. The fair value is expected to recover as the bonds approach maturity.

At December 31, 2010, there were no securities in a continuous loss position for greater than twelve months. The gross unrealized losses of securities that have been in a continuous loss position for less than twelve months totaled $407,069 at December 31, 2010. The unrealized losses on the Bank's investments were caused by interest rate fluctuations and other market conditions. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Bank does not intend to sell, and it is more likely than not that it will not be required to sell those securities until a recovery of fair value, which may be maturity, the Bank does not consider those investments to be other-than-temporarily impaired at December 31, 2010.

(Continued)

**NOTE 2 – AVAILABLE-FOR-SALE INVESTMENT SECURITIES** (Continued)

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2011 by contractual maturity are shown below. Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties.

| | Amortized Cost | Estimated Fair Value |
|---|---|---|
| Within one year | $ 1,233,643 | $ 1,270,313 |
| After one year through five years | 3,641,350 | 3,637,513 |
| After five years through ten years | 14,336,333 | 15,101,253 |
| After ten years | 4,202,690 | 4,452,155 |
| | 23,414,016 | 24,461,234 |
| Investment securities not due at a single maturity date: | | |
| U.S. Government sponsored entities and agencies collateralized by mortgage obligations | 12,422,648 | 12,477,945 |
| Residential mortgage-backed securities | 35,593,081 | 36,564,790 |
| | $ 71,429,745 | $ 73,503,969 |

The Bank also had securities pledged with amortized costs totaling $32,990,257 and $8,837,720 and estimated fair values totaling approximately $34,637,148 and $9,100,000 for certain borrowing arrangements with the Federal Home Loan Bank of San Francisco as of December 31, 2011 and 2010, respectively (see Note 6).

**NOTE 3 – LOANS**

Outstanding loans are summarized below:

| | December 31, | |
|---|---|---|
| | 2011 | 2010 |
| Agriculture | $ 2,883,097 | $ 6,037,214 |
| Commercial | 8,556,203 | 4,816,904 |
| Commercial real estate | 15,179,419 | 16,471,151 |
| Real estate – other | 20,164,848 | 15,959,182 |
| Consumer and other | 233,178 | 232,557 |
| | 47,016,745 | 43,517,008 |
| Deferred loan fees, net | (92,314) | (56,117) |
| Allowance for loan losses | (1,593,570) | (1,438,518) |
| | $ 45,330,861 | $ 42,022,373 |

(Continued)

**NOTE 3 – LOANS** (Continued)

The following table presents the activity in the allowance for loan losses by portfolio segment for the period ending December 31, 2011:

| | December 31, 2011 | | | | | |
|---|---|---|---|---|---|---|
| | Agriculture | Commercial | Commercial Real Estate | Real Estate – Other | Consumer | Total |
| December 31, 2011 | | | | | | |
| Allowance for loan losses: | | | | | | |
| Beginning balance | $ 95,388 | $ 144,858 | $ 690,921 | $ 501,118 | $ 6,233 | $ 1,438,518 |
| Provision for loan losses | (46,664) | 10,447 | 148,073 | 78,581 | (437) | 190,000 |
| Loans charged-off | | | (73,173) | | (992) | (74,165) |
| Recoveries | | 31,905 | 7,312 | | | 39,217 |
| Total ending allowance balance | $ 48,724 | $ 187,210 | $ 773,133 | $ 579,699 | $ 4,804 | $ 1,593,570 |

Changes in the allowance for loan losses at December 31, 2010 were as follows:

| | 2010 |
|---|---|
| Balance, beginning of year | $ 1,135,459 |
| Provision for loan losses | 600,000 |
| Loans charged-off | (297,631) |
| Recoveries | 690 |
| Balance, end of year | $ 1,438,518 |

The following table presents the allocation of the allowance for loan losses and recorded investment in loans at and for the year ended December 31, 2011 and 2010 by portfolio segment and by impairment methodology:

| | December 31, 2011 | | | | | |
|---|---|---|---|---|---|---|
| | Agriculture | Commercial | Commercial Real Estate | Real Estate – Other | Consumer | Total |
| Allowance for Credit Losses | | | | | | |
| Ending balance: individually evaluated for impairment | $ - | $ - | $ - | $ - | $ - | $ - |
| Ending balance: collectively evaluated for impairment | $ 48,724 | $ 187,210 | $ 773,133 | $ 579,699 | $ 4,804 | $ 1,593,570 |
| Loans | | | | | | |
| Ending balance | $ 2,883,097 | $ 8,556,203 | $ 15,179,419 | $ 20,164,848 | $ 233,178 | $ 47,016,745 |
| Ending balance: individually evaluated for impairment | $ - | $ - | $ 1,079,039 | $ - | $ - | $ 1,079,039 |
| Ending balance: collectively evaluated for impairment | $ 2,883,097 | $ 8,556,203 | $ 14,100,380 | $ 20,164,848 | $ 233,178 | $ 45,937,706 |

(Continued)

**NOTE 3 – LOANS** (Continued)

| | December 31, 2010 | | | | | |
|---|---|---|---|---|---|---|
| | Agriculture | Commercial | Commercial Real Estate | Real Estate – Other | Consumer | Total |
| Allowance for Credit Losses | | | | | | |
| Ending balance allocated to portfolio segments | $ 95,388 | $ 144,858 | $ 690,921 | $ 501,118 | $ 6,233 | $ 1,438,518 |
| Ending balance: individually evaluated for impairment | $ - | $ - | $ 149,128 | $ - | $ - | $ 149,128 |
| Ending balance: collectively evaluated for impairment | $ 95,388 | $ 144,858 | $ 541,793 | $ 501,118 | $ 6,233 | $ 1,289,390 |
| Loans | | | | | | |
| Ending balance | $ 6,037,214 | $ 4,816,904 | $ 16,471,151 | $ 15,959,182 | $ 232,557 | $ 43,517,008 |
| Ending balance: individually evaluated for impairment | $ - | $ 4,337 | $ 942,973 | $ - | $ - | $ 947,310 |
| Ending balance: collectively evaluated for impairment | $ 6,037,214 | $ 4,812,567 | $ 15,528,178 | $ 15,959,182 | $ 232,557 | $ 42,569,698 |

The following table presents the loan portfolio allocated by management's internal risk ratings at December 31, 2011 and 2010:

| | December 31, 2011 | | | | | |
|---|---|---|---|---|---|---|
| | Credit Quality Indicators<br>Credit Risk Profile by Internally Assigned Grade | | | | | |
| | Agriculture | Commercial | Commercial Real Estate | Real Estate – Other | Consumer | Total |
| Grade: | | | | | | |
| Pass | $ 2,883,097 | $ 7,637,570 | $ 12,490,719 | $ 18,550,602 | $ 231,082 | $ 41,793,070 |
| Special Mention | | 200,000 | | | | 200,000 |
| Substandard | | 718,633 | 2,552,503 | 1,614,246 | 2,096 | 4,887,478 |
| Doubtful | | | 136,197 | | | 136,197 |
| Total | $ 2,883,097 | $ 8,556,203 | $ 15,179,419 | $ 20,164,848 | $ 233,178 | $ 47,016,745 |

| | December 31, 2010 | | | | | |
|---|---|---|---|---|---|---|
| | Credit Quality Indicators<br>Credit Risk Profile by Internally Assigned Grade | | | | | |
| | Agriculture | Commercial | Commercial Real Estate | Real Estate – Other | Consumer | Total |
| Grade: | | | | | | |
| Pass | $ 6,006,346 | $ 3,105,551 | $ 11,081,363 | $ 13,784,548 | $ 228,851 | $ 34,206,659 |
| Special Mention | 30,868 | 969,791 | 2,738,233 | 252,006 | | 3,990,898 |
| Substandard | | 741,562 | 2,651,555 | 1,922,628 | 3,706 | 5,319,451 |
| Doubtful | | | | | | |
| Total | $ 6,037,214 | $ 4,816,904 | $ 16,471,151 | $ 15,959,182 | $ 232,557 | $ 43,517,008 |

(Continued)

**NOTE 3 – LOANS** (Continued)

The following table presents an aging analysis of the loan portfolio by the time past due at December 31, 2011:

| | 30-89 Days Past Due | 90 Days and Still Accruing | Nonaccrual | Total Past Due | Current | Total |
|---|---|---|---|---|---|---|
| Agriculture | | | | | $ 2,883,097 | $ 2,883,097 |
| Commercial | | | | | 8,556,203 | 8,556,203 |
| Commercial real estate | | | $ 136,197 | $ 136,197 | 15,043,222 | 15,179,419 |
| Real estate – other | | | | | 20,164,848 | 20,164,848 |
| Consumer | | | | | 233,178 | 233,178 |
| Total | $ - | $ - | $ 136,197 | $ 136,197 | $46,880,548 | $47,016,745 |

The following table shows information related to impaired loans at and for the year ended December 31, 2011 and 2010:

| | December 31, 2011 | | | | | |
|---|---|---|---|---|---|---|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized | Cash Basis Interest Recognized |
| With no related allowance recorded: | | | | | | |
| Agriculture | | | | | | |
| Commercial | | | | | | |
| Commercial real estate | $ 1,079,039 | $ 1,146,450 | | $ 1,144,184 | $ 47,799 | |
| Real estate – other | | | | | | |
| Consumer | | | | | | |
| With an allowance recorded: | | | | | | |
| Agriculture | | | | | | |
| Commercial | | | | | | |
| Commercial real estate | | | | | | |
| Real estate – other | | | | | | |
| Consumer | | | | | | |
| Total: | | | | | | |
| Agriculture | | | | | | |
| Commercial | | | | | | |
| Commercial real estate | $ 1,079,039 | $ 1,146,450 | | $ 1,144,184 | $ 47,799 | |
| Real estate – other | | | | | | |
| Consumer | | | | | | |

(Continued)

**NOTE 3 – LOANS** (Continued)

| | December 31, 2010 | | | | | |
|---|---|---|---|---|---|---|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized | Cash Basis Interest Recognized |
| With no related allowance recorded: | | | | | | |
| Agriculture | | | | | | |
| Commercial | $ 4,337 | $ 103,409 | | $ 5,300 | | |
| Commercial real estate | | | | | | |
| Real estate – other | | | | | | |
| Consumer | | | | | | |
| With an allowance recorded: | | | | | | |
| Agriculture | | | | | | |
| Commercial | | | | | | |
| Commercial real estate | $ 942,973 | $ 942,973 | $ 149,128 | $ 954,473 | $ 30,897 | |
| Real estate – other | | | | | | |
| Consumer | | | | | | |
| Total: | | | | | | |
| Agriculture | | | | | | |
| Commercial | $ 4,337 | $ 103,409 | | $ 5,300 | | |
| Commercial real estate | $ 942,973 | $ 942,973 | $ 149,128 | $ 954,473 | $ 30,897 | |
| Real estate – other | | | | | | |
| Consumer | | | | | | |

No specific reserves were allocated to customers whose loan terms have been modified in troubled debt restructurings as of December 31, 2011.

The Bank has allocated $149,128 of specific reserves to customers whose loan terms were modified in troubled debt restructurings as of December 31, 2010. The Bank has not committed to lend any additional amounts as of December 31, 2011 and 2010 to customers with outstanding loans that are classified as troubled debt restructurings. During the period ended December 31, 2011, there were no troubled debt restructurings identified.

In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under the Bank's underwriting policy.

Certain loans which were modified during the period ended December 31, 2011 and did not meet the definition of a troubled debt restructuring as the modification was a delay in a payment that was considered to be insignificant had delays in payment ranging from 10 to 29 days.

(Continued)

## NOTE 4 – PREMISES AND EQUIPMENT

Premises and equipment consisted of the following:

| | December 31, | |
|---|---|---|
| | 2011 | 2010 |
| Land | $ 774,631 | $ 774,631 |
| Premises | 1,550,724 | 1,550,724 |
| Furniture, fixtures and equipment | 250,804 | 227,532 |
| | 2,576,159 | 2,552,887 |
| Less accumulated depreciation | (344,313) | (300,482) |
| | $ 2,231,846 | $ 2,252,405 |

Depreciation included in occupancy and equipment expense totaled $90,640 and $77,802 for the years ended December 31, 2011 and 2010, respectively.

## NOTE 5 – INTEREST-BEARING DEPOSITS

Interest-bearing deposits consisted of the following:

| | December 31, | |
|---|---|---|
| | 2011 | 2010 |
| Savings | $ 583,699 | $ 576,455 |
| Money market | 59,416,241 | 65,402,910 |
| Interest-bearing demand accounts | 9,033,583 | 9,018,922 |
| Time, under $100,000 | 2,883,915 | 2,661,108 |
| Time, $100,000 or more | 16,504,697 | 15,236,798 |
| | $ 88,422,135 | $ 92,896,193 |

Aggregate annual maturities of time deposits are as follows:

| Years Ending December 31, | |
|---|---|
| 2012 | $ 18,034,792 |
| 2013 | 1,040,489 |
| 2014 | 201,520 |
| 2015 | 56,111 |
| 2016 | 55,700 |
| | $ 19,388,612 |

(Continued)

**NOTE 5 – INTEREST-BEARING DEPOSITS** (Continued)

Interest expense recognized on interest-bearing deposits for the years ended December 31, 2011 and 2010 consisted of the following:

| | 2011 | 2010 |
|---|---|---|
| Savings | $ 471 | $ 4,825 |
| Money market | 283,617 | 354,125 |
| Interest-bearing demand accounts | 10,392 | 10,763 |
| Time, $100,000 or more | 133,263 | 205,099 |
| Other time | 18,236 | 24,114 |
| | $ 445,979 | $ 598,926 |

**NOTE 6 – BORROWING ARRANGEMENTS**

The Bank has unsecured Federal funds lines of credit with correspondent banks under which it can borrow up to $6,000,000. There were no borrowings outstanding under these arrangements at December 31, 2011 and 2010, respectively.

In addition, the Bank has an arrangement with the Federal Home Loan Bank (FHLB) under which it may borrow an amount not to exceed 15% of total assets which must be fully secured by qualifying securities. At December 31, 2011 and 2010, the fair value of investment securities pledged was approximately $34,637,000 and $9,121,000, respectively, and the amount of borrowings available under this arrangement was approximately $32,854,000 and $8,665,000. As of December 31, 2011 and 2010, the Bank did not have borrowings outstanding with the FHLB.

**NOTE 7 – INCOME TAXES**

Income taxes for the years ended December 31, 2011 and 2010 consisted of the following:

| | 2011 | 2010 |
|---|---|---|
| Current | $ 602,044 | $ 662,621 |
| Deferred | (16,700) | (293,900) |
| Income tax expense | $ 585,344 | $ 368,721 |

(Continued)

**NOTE 7 – INCOME TAXES** (Continued)

Deferred tax assets (liabilities) consisted of the following:

| | December 31, | |
|---|---|---|
| | 2011 | 2010 |
| Deferred tax assets: | | |
| State net operating losses | $ 76,000 | $ 76,000 |
| Organization costs | 85,500 | 94,600 |
| Allowance for loan losses | 695,800 | 621,100 |
| Share-based payments | 123,100 | 108,200 |
| Other real estate owned | | 34,300 |
| Other | 25,300 | 19,700 |
| Total deferred tax assets | 1,005,700 | 953,900 |
| Deferred tax liabilities: | | |
| Accrual to cash conversion | (201,900) | (208,900) |
| Future liability of state deferred tax asset | (24,200) | (25,200) |
| Unrealized gain on available-for-sale investment securities | (829,700) | (412,700) |
| Other | (60,300) | (17,200) |
| Total deferred tax liabilities | (1,116,100) | (664,000) |
| Net deferred tax (liability) asset | $ (110,400) | $ 289,900 |

The provision for income taxes differs from amounts computed by applying the statutory federal income tax rate to operating income before income taxes. The significant items comprising these differences consisted of the following:

| | Year Ended December 31, | | | |
|---|---|---|---|---|
| | 2011 | | 2010 | |
| | Amount | Rate % | Amount | Rate % |
| Federal income tax expense at statutory rates | $ 626,140 | 34.0 | $ 479,687 | 34.0 |
| State franchise tax expense, net of federal tax benefit | 117,616 | 6.4 | 8,004 | 0.6 |
| Tax exempt investment security income, net | (162,758) | (8.8) | (121,036) | (8.6) |
| Non-deductible stock option expense | 32,004 | 1.7 | 16,148 | 1.1 |
| Other | (27,658) | (1.5) | (14,082) | (1.0) |
| Total income tax expense | $ 585,344 | 31.8 | $ 368,721 | 26.1 |

(Continued)

**NOTE 7 – INCOME TAXES** (Continued)

The Bank is subject to U.S. federal income tax as well as California state franchise tax. Federal tax returns for 2010, 2009 and 2008 are currently open for examination. California state franchise tax returns for 2010, 2009, 2008 and 2007 are currently open for examination.

At December 31, 2011, the Bank had California net operating loss carryforwards (NOLs) of approximately $700,000 available to offset future California income. The State of California has suspended the Bank's ability to utilize these NOLs in 2010 and 2011; however, the suspension provided the Bank with additional time to utilize them. These NOLs currently begin to expire in 2020.

**NOTE 8 – COMMITMENTS AND CONTINGENCIES**

Financial Instruments With Off-Balance-Sheet Risk: The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business in order to meet the financing needs of its customers. These financial instruments consist of the following:

| | December 31, | |
|---|---|---|
| | 2011 | 2010 |
| Commitments to extend credit | $ 9,574,668 | $ 12,003,851 |

The Bank's exposure to credit loss in the event of nonperformance by the other party for commitments to extend credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments as it does for loans included on the balance sheet.

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. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies, but may include accounts receivable, inventory, and deeds of trust on residential real estate and income-producing commercial properties.

Commercial loan commitments represent approximately 39% of total commitments and are generally unsecured or secured by collateral other than real estate and have variable interest rates. Agricultural loan commitments represent approximately 25% of total commitments and are generally secured by crop assignments, accounts receivable and farm equipment and have variable interest rates. Real estate loan commitments represent approximately 11% of total commitments and are generally secured by property with a loan-to-value ratio not to exceed 75%. The majority of real estate commitments also have variable interest rates. Home equity lines of credit represent the remaining 23% of total commitments and are generally secured by residential real estate and have both variable and fixed interest rates.

(Continued)

**NOTE 8 – COMMITMENTS AND CONTINGENCIES** (Continued)

Concentrations of Credit Risk: The Bank grants real estate mortgage, real estate construction and commercial loans to customers in Sutter, Yuba and surrounding counties. Although the Bank intends to have a diversified loan portfolio, a substantial portion of its portfolio is secured by commercial real estate at December 31, 2011.

In management's judgment, a concentration of loans exists in real estate related loans with approximately 75% of the Bank's loans being real estate related. Although management believes the loans within this concentration have no more than the normal risk of collectibility, a substantial decline in the performance of the economy in general or a decline in real estate values in the Bank's primary market area, in particular, could have an adverse impact on the collectibility of these loans. Personal and business income represent the primary source of repayment for a majority of these loans.

Deposit Concentration: The Bank has a limited number of deposit relationships that in the aggregate represent approximately 26% of the Bank's deposits at December 31, 2011. These relationships are primarily with related parties (see Note 11). The loss of one or more of these deposit relationships could have a material impact on the Bank's operations and liquidity. However, management mitigates this risk by ensuring that these deposit relationships are fully developed through ongoing contact with both executive management and account officers and by maintaining sufficient liquidity to manage fluctuations in account balances within these larger relationships.

Correspondent Banking Agreements: The Bank maintains funds on deposit with other federally insured financial institutions under correspondent banking agreements. There were no uninsured deposits at December 31, 2011.

**NOTE 9 – SHARE-BASED PAYMENTS**

The Bank has one share-based compensation plan, the River Valley Community Bank Equity Incentive Stock Option Plan (the "Plan"), which has been approved by its shareholders. Under the Plan, 226,936 shares of common stock are reserved for future grants of awards to employees, directors and consultants under incentive and nonstatutory stock option agreements. The Plan is designed to attract and retain employees and directors. The amount, frequency, and terms of share-based awards may vary based on competitive practices, the Bank's operating results and government regulations. Generally, stock options vest over a five year term and expire ten years after the date of grant. New shares are issued upon option exercise or restricted share grants. The Plan does not provide for the settlement of awards in cash. The Plan requires that the option price may not be less than the fair market value of the stock at the date the option is granted, and that the stock must be paid in full at the time the option is exercised.

Restricted stock awards are grants of shares of common stock that are subject to forfeiture until specific conditions or goals are met. Conditions may be based on continuing employment or achieving specified performance goals. During the period of restriction, participants holding restricted stock may have full voting and dividend rights. The restrictions lapse in accordance with a schedule or with other conditions determined by the Board of Directors. No awards of restricted stock were made during the years ended December 31, 2011 and 2010.

(Continued)

**NOTE 9 – SHARE-BASED PAYMENTS** (Continued)

A summary of option activity under the Plan for the year ended December 31, 2011 is presented below:

| Options | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term |
|---|---|---|---|
| Outstanding at beginning of year | 286,250 | $ 8.68 | |
| Granted | 1,750 | $ 9.55 | |
| Forfeited | (1,037) | $ 8.81 | |
| Exercised | (150) | $ 8.81 | |
| Outstanding at December 31, 2011 | 286,813 | $ 8.67 | 5.26 years |
| Exercisable at December 31, 2011 | 248,538 | $ 8.16 | 4.79 years |

As of December 31, 2011, the unrecognized compensation cost related to non-vested stock option awards totaled $150,967. That cost is expected to be amortized on a straight-line basis over a weighted average period of two years and will be adjusted for subsequent changes in estimated forfeitures.

The following stock option information is for years ended December 31, 2011 and 2010:

| | 2011 | 2010 |
|---|---|---|
| Weighted average grant date fair value per share of options granted | $2.76 | $2.75 |
| Significant fair value assumptions: | | |
| Expected term in years | 6.5 years | 6.3 years |
| Expected annual volatility | 32.68% | 39.28% |
| Expected annual dividend yield | N/A | N/A |
| Risk-free interest rate | 1.34% | 2.48% |
| Total compensation cost (included in salaries and employee benefits and other expense) | $111,144 | $79,344 |

**NOTE 10 – SHAREHOLDERS' EQUITY**

Dividends: Upon declaration by the Board of Directors, all shareholders of record will be entitled to receive dividends. The California Financial Code restricts the total dividend payment of any state banking association in any calendar year to the lesser of (1) the bank's retained earnings or (2) the bank's net income for its last three fiscal years, less distributions made to shareholders during the same three-year period. At December 31, 2011, retained earnings of $2,762,209 were free of such restrictions.

(Continued)

**NOTE 10 – SHAREHOLDERS' EQUITY** (Continued)

Five for Four Stock Split: On June 15, 2010, the Board of Directors approved a five for four stock split of its shares of common stock, effective at the close of business on July 30, 2010 (the "Effective Date"). As of the Effective Date, each four outstanding shares of common stock were exchanged--without further action--into five shares of common stock. The primary purpose of the stock split was to enhance the liquidity of the stock by making more shares available to each shareholder. All share and per share data has been retroactively restated to reflect the stock split.

Regulatory Capital: The Bank is subject to certain regulatory capital requirements administered by the FDIC. Failure to meet these 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 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 of total and Tier 1 capital to risk-weighted assets and of Tier 1 capital to average assets. Each of these components is defined in the regulations. Management believes that the Bank meets all its capital adequacy requirements as of December 31, 2011.

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 below.

| | 2011 | | 2010 | |
|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio |
| Leverage Ratio | | | | |
| River Valley Community Bank | $ 17,073,000 | 12.7% | $ 15,705,000 | 12.5% |
| Minimum requirement for "Well-Capitalized" institution | $ 6,727,200 | 5.0% | $ 6,265,559 | 5.0% |
| Minimum regulatory requirement | $ 5,381,760 | 4.0% | $ 5,012,447 | 4.0% |
| Tier 1 Risk-Based Capital Ratio | | | | |
| River Valley Community Bank | $ 17,073,000 | 24.0% | $ 15,705,000 | 21.5% |
| Minimum requirement for "Well-Capitalized" institution | $ 4,261,200 | 6.0% | $ 4,381,020 | 6.0% |
| Minimum regulatory requirement | $ 2,840,800 | 4.0% | $ 2,920,680 | 4.0% |

(Continued)

**NOTE 10 – SHAREHOLDERS' EQUITY** (Continued)

| | 2011 | | 2010 | |
|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio |
| Total Risk-Based Capital Ratio | | | | |
| River Valley Community Bank | $ 17,970,000 | 25.3% | $ 16,624,000 | 22.8% |
| Minimum requirement for "Well-Capitalized" institution | $ 7,102,000 | 10.0% | $ 7,301,700 | 10.0% |
| Minimum regulatory requirement | $ 5,681,600 | 8.0% | $ 5,841,360 | 8.0% |

**NOTE 11 – RELATED PARTY TRANSACTIONS**

During the normal course of business, the Bank enters into transactions with related parties, including Directors and executive officers. The following is a summary of the aggregate activity involving related party borrowers for the year ended December 31, 2011:

| | |
|---|---|
| Beginning balance | $ 4,909,092 |
| Disbursements | 2,363,090 |
| Amounts repaid | (3,133,308) |
| Balance, December 31, 2011 | $ 4,138,874 |
| Undisbursed commitments to related parties, December 31, 2011 | $ 877,202 |

At December 31, 2011 the Bank's deposits from related parties totaled $32,096,204 or 26% of the Bank's total deposits. These related parties include Directors, executive officers and their affiliates. These depositors have strong relationships and connections with management. As a result, management believes these circumstances mitigate the risk of unexpected volatility of their deposits.

**NOTE 12 – EMPLOYEE BENEFIT PLAN**

Profit Sharing Plan: The Bank has a 401(k) profit sharing plan. All employees 18 years of age or older with 30 days of service are eligible to participate in the plan. Eligible employees may elect to make tax deferred contributions up to the maximum amount allowed by law. The Bank may make additional contributions to the plan at the discretion of the Board of Directors. Bank contributions vest at a rate of 25% annually for all employees. A contribution of $34,372 was made for the year ended December 31, 2011. A contribution of $27,821 was made for the year ended December 31, 2010.

(Continued)

**NOTE 13 – FAIR VALUE MEASUREMENTS**

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

| | December 31, 2011 | | December 31, 2010 | |
|---|---|---|---|---|
| | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| Financial assets: | | | | |
| Cash and due from banks | $ 5,689,203 | $ 5,689,203 | $ 4,299,235 | $ 4,299,235 |
| Federal funds sold | 10,177,870 | 10,177,870 | 19,214,838 | 19,214,838 |
| Interest-bearing deposits in banks | 1,245,000 | 1,245,000 | 747,000 | 747,000 |
| Available-for-sale investment securities | 73,503,969 | 73,503,969 | 64,801,749 | 64,801,749 |
| Loans, net | 45,330,861 | 45,450,377 | 42,022,373 | 41,982,430 |
| Accrued interest receivable | 570,171 | 570,171 | 618,002 | 618,002 |
| FHLB stock | 679,900 | N/A | 578,500 | N/A |
| Financial liabilities: | | | | |
| Deposits | $ 121,160,200 | $ 121,189,949 | $ 119,410,908 | $ 119,446,061 |
| Accrued interest payable | 22,757 | 22,757 | 22,779 | 22,779 |

These estimates do not reflect any premium or discount that could result from offering the Bank's entire holdings of a particular financial instrument for sale at one time, nor do they attempt to estimate the value of anticipated future business related to the instruments. In addition, the tax ramifications related to the realization of unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of these estimates.

The following methods and assumptions were used to estimate the fair value of financial instruments. For cash and due from banks, Federal funds sold, interest-bearing deposits in banks, variable-rate loans and leases, accrued interest receivable and payable, demand deposits and short-term borrowings, the carrying amount is estimated to be fair value. For investment securities, fair values are based on quoted market prices, quoted market prices for similar securities and indications of value provided by brokers. The fair values for fixed-rate loans and leases are estimated using discounted cash flow analyses, using interest rates currently being offered at each reporting date for loans with similar terms to borrowers of comparable creditworthiness. It was not practicable to determine the fair value of FHLB stock due to restrictions placed on its transferability. Fair values for fixed-rate certificates of deposit are estimated using discounted cash flow analyses using interest rates offered at each reporting date by the Bank for certificates with similar remaining maturities. The fair values of commitments are not significant.

Fair Value Hierarchy: When the Bank is required to measure certain assets or liabilities at fair value, it measures the estimated fair value of such assets and liabilities in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. Valuations within these levels are based upon:

Level 1 – Quoted market prices for identical instruments traded in active exchange markets.

Level 2 – Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable or can be corroborated by observable market data.

(Continued)

**NOTE 13 – FAIR VALUE MEASUREMENTS** (Continued)

Level 3 – Model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect the Bank's estimates of assumptions that market participants would use on pricing the asset or liability. Valuation techniques include management judgment and estimation which may be significant.

Management monitors the availability of observable market data to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, the transfer is reported at the beginning of the reporting period.

Management evaluates the significance of transfers between levels based upon the nature of the financial instrument and size of the transfer relative to total assets, total liabilities or total earnings.

The following tables present information about the Bank's assets measured at fair value on a recurring and nonrecurring basis as of December 31, 2011 and 2010:

*Recurring Basis*

| | December 31, 2011 | | | |
|---|---|---|---|---|
| Description | Fair Value | Level 1 | Level 2 | Level 3 |
| Debt securities: | | | | |
| U.S. Government agencies | $ 2,568,028 | | $ 2,568,028 | |
| Obligations of state and political subdivisions | 15,260,977 | | 15,260,977 | |
| U.S. Government agencies collateralized by mortgage obligations | 12,477,945 | | 12,477,945 | |
| Mortgage-backed securities | 36,564,791 | | 36,564,790 | |
| Other debt securities | 6,632,228 | | 6,632,228 | |
| Total assets measured at fair value | $ 73,503,969 | $ - | $ 73,503,969 | $ - |

| | December 31, 2010 | | | |
|---|---|---|---|---|
| Description | Fair Value | Level 1 | Level 2 | Level 3 |
| Debt securities: | | | | |
| U.S. Government agencies | $ 2,642,848 | | $ 2,642,848 | |
| Obligations of state and political subdivisions | 11,113,068 | | 11,113,068 | |
| U.S. Government agencies collateralized by mortgage obligations | 14,598,620 | | 14,598,620 | |
| Mortgage-backed securities | 28,270,378 | | 28,270,378 | |
| Other debt securities | 8,176,835 | | 8,176,835 | |
| Total assets measured at fair value | $ 64,801,749 | $ - | $ 64,801,749 | $ - |

Fair values for available-for-sale investment securities are based on quoted market prices for similar securities. During the year ended December 31, 2011, there were no significant transfers in or out of Levels 1 and 2.

(Continued)

**NOTE 13 – FAIR VALUE MEASUREMENTS** (Continued)

*Non-recurring Basis*

| | December 31, 2011 | | | |
|---|---|---|---|---|
| Description | Fair Value | Level 1 | Level 2 | Level 3 |
| Impaired loans – commercial real estate | $ 136,197 | $ - | $ - | $ 136,197 |

| | December 31, 2010 | | | |
|---|---|---|---|---|
| Description | Fair Value | Level 1 | Level 2 | Level 3 |
| Impaired loans – commercial real estate | $ 795,605 | $ - | $ - | $ 795,605 |
| Other real estate owned - residential | $ 657,400 | $ - | $ - | $ 657,400 |

The fair value of impaired loans measured on a non-recurring basis is based on downward adjustments taken as a result of appraisals received on collateral dependent loans.

Other real estate owned is measured at fair value on a non-recurring basis when the fair value of other real estate owned, net of estimated costs to sell, is less than its carrying value. In 2010, the Bank recorded a $198,000 charge off to reduce the carrying value of other real estate owned to $657,400, which value was based on a third-party appraisal less estimated costs to sell. Management considers an appraisal to be a Level 3 measurement of fair value.