

RIVER VALLEY COMMUNITY BANK
Yuba City, California

FINANCIAL STATEMENTS
December 31, 2013 and 2012

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INDEPENDENT AUDITOR'S REPORT

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

Report on the Financial Statements

We have audited the accompanying financial statements of River Valley Community Bank, which comprise the balance sheets as of December 31, 2013 and 2012 and the related statements of income, comprehensive income, changes in shareholders' equity and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 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 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 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 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 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 financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of River Valley Community Bank as of December 31, 2013 and 2012, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Crowe Horwath LLP
Crowe Horwath LLP

Sacramento, California
March 18, 2014

RIVER VALLEY COMMUNITY BANK
BALANCE SHEETS
December 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
ASSETS		
Cash and due from banks	\$ 7,162,817	\$ 5,894,250
Federal funds sold	<u>23,774,309</u>	<u>16,718,046</u>
Total cash and cash equivalents	30,937,126	22,612,296
Interest-bearing deposits in other banks	3,231,000	2,486,000
Available-for-sale investment securities (Notes 2 and 14)	61,952,844	64,540,935
Loans, less allowance for loan losses of \$ 1,569,104 in 2013 and \$1,565,354 in 2012 (Notes 3, 8, 12 and 14)	61,747,821	53,671,228
Premises and equipment, net (Note 4)	2,270,803	2,207,618
Bank owned life insurance	4,160,856	4,050,416
Accrued interest receivable and other assets	<u>2,086,215</u>	<u>2,417,510</u>
	<u>\$ 166,386,665</u>	<u>\$ 151,986,003</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest bearing	\$ 46,951,800	\$ 35,176,216
Interest bearing (Note 5)	<u>99,413,265</u>	<u>95,199,947</u>
Total deposits	146,365,065	130,376,163
Accrued interest payable and other liabilities	<u>255,945</u>	<u>2,093,234</u>
Total liabilities	<u>146,621,010</u>	<u>132,469,397</u>
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 – 1,734,473 shares in 2013 and 1,718,235 in 2012	14,630,069	14,402,816
Retained earnings	4,944,286	3,697,806
Accumulated other comprehensive income (Note 2)	<u>191,300</u>	<u>1,415,984</u>
Total shareholders' equity	<u>19,765,655</u>	<u>19,516,606</u>
Total liabilities and shareholders' equity	<u>\$ 166,386,665</u>	<u>\$ 151,986,003</u>

See accompanying notes to financial statements.

RIVER VALLEY COMMUNITY BANK
STATEMENTS OF INCOME
Years Ended December 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Interest income:		
Interest and fees on loans	\$ 2,995,825	\$ 3,024,611
Interest on Federal funds sold	35,265	22,901
Interest on certificates of deposit with other banks	46,380	33,695
Interest on investment securities		
Taxable	939,306	1,330,215
Exempt from Federal income taxes	<u>625,989</u>	<u>539,038</u>
Total interest income	<u>4,642,765</u>	<u>4,950,460</u>
Interest expense:		
Interest on deposits (Note 5)	<u>212,731</u>	<u>334,926</u>
Net interest income	4,430,034	4,615,534
Provision for loan losses (Note 3)	<u>-</u>	<u>-</u>
Net interest income after provision for loan losses	<u>4,430,034</u>	<u>4,615,534</u>
Non-interest income:		
Service charges and fees	237,179	200,286
Increase in cash surrender value of bank owned life insurance	110,440	50,416
Gain on sale of investments (Note 2)	64,015	136,174
Other	<u>30,386</u>	<u>46,165</u>
Total non-interest income	<u>442,020</u>	<u>433,041</u>
Non-interest expense:		
Salaries and employee benefits (Notes 3, 9 and 13)	1,904,589	1,742,892
Occupancy and equipment (Note 4)	267,962	208,162
Data processing	335,731	258,013
FDIC insurance and assessments	72,834	187,774
Professional fees	135,446	128,367
Other	<u>491,380</u>	<u>427,004</u>
Total non-interest expense	<u>3,207,942</u>	<u>2,952,212</u>
Net income before provision for income taxes	1,664,112	2,096,363
Provision for income taxes (Note 7)	<u>417,632</u>	<u>645,297</u>
Net income	<u>\$ 1,246,480</u>	<u>\$ 1,451,066</u>
Basic earnings per share	<u>\$ 0.72</u>	<u>\$ 0.85</u>
Diluted earnings per share	<u>\$ 0.67</u>	<u>\$ 0.79</u>

See accompanying notes to financial statements.

RIVER VALLEY COMMUNITY BANK
STATEMENTS OF COMPREHENSIVE INCOME
Years Ended December 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Net income	\$ 1,246,480	\$ 1,451,066
Other comprehensive (loss) income:		
Unrealized (losses) gains on securities:		
Unrealized holding (losses) gains arising during the period	(1,977,126)	421,924
Reclassification adjustment for gains included in net income	(64,015)	(136,174)
Tax effect	<u>816,457</u>	<u>(114,300)</u>
Total other comprehensive (loss) income	<u>(1,224,684)</u>	<u>171,450</u>
Comprehensive income	<u>\$ 21,796</u>	<u>\$ 1,622,516</u>

See accompanying notes to financial statements.

RIVER VALLEY COMMUNITY BANK
STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Years Ended December 31, 2013 and 2012

	<u>Common Stock</u>		<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income, Net</u>	<u>Total Shareholders' Equity</u>
	<u>Shares</u>	<u>Amount</u>			
Balance, January 1, 2012	1,716,935	\$ 14,311,302	\$ 2,762,209	\$ 1,244,534	\$ 18,318,045
Net income	-	-	1,451,066	-	1,451,066
Other comprehensive income	-	-	-	171,450	171,450
Cash dividends declared (\$0.30 per share)	-	-	(515,469)	-	(515,469)
Exercise of stock options (Note 9)	1,300	11,240	-	-	11,240
Share-based payments (Note 9)	-	80,274	-	-	80,274
Balance, December 31, 2012	1,718,235	\$ 14,402,816	\$ 3,697,806	\$ 1,415,984	\$ 19,516,606
Net income	-	-	1,246,480	-	1,246,480
Other comprehensive loss	-	-	-	(1,224,684)	(1,224,684)
Exercise of stock options (Note 9)	16,238	132,092	-	-	132,092
Share-based payments (Note 9)	-	95,161	-	-	95,161
Balance, December 31, 2013	<u>1,734,473</u>	<u>\$ 14,360,069</u>	<u>\$ 4,944,286</u>	<u>\$ 191,300</u>	<u>\$ 19,765,655</u>

See accompanying notes to financial statements.

RIVER VALLEY COMMUNITY BANK
STATEMENTS OF CASH FLOWS
Years Ended December 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Cash flows from operating activities:		
Net income	\$ 1,246,480	\$ 1,451,066
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses		
Depreciation, amortization and accretion	519,605	544,738
Increase in cash surrender value of bank owned life insurance	(110,440)	(50,416)
Gain on sale of available-for-sale investment securities	(64,015)	(136,174)
Gain on sale of other real estate owned	(15,309)	-
Net (decrease) increase in deferred loan fees	(20,762)	27,118
Deferred income tax expense (benefit)	58,700	(32,800)
Share-based payments	95,161	80,274
Net decrease in accrued interest receivable and other assets	984,345	9,396
Net (decrease) increase in accrued interest payable and other liabilities	<u>(1,837,289)</u>	<u>1,035,990</u>
Net cash provided by operating activities	<u>856,476</u>	<u>2,929,192</u>
Cash flows from investing activities:		
Net increase in interest-bearing deposits in other banks	(745,000)	(1,241,000)
Purchases of available-for-sale investment securities	(19,172,828)	(8,400,851)
Proceeds from maturities and calls of available-for-sale investment securities	2,000,000	1,250,000
Proceeds from principle payments on available-for-sale investment securities	12,416,098	13,442,312
Proceeds from sales of available-for-sale investment securities	4,972,607	2,639,878
Proceeds from sale of other real estate owned	116,559	-
Purchase of bank owned life insurance	-	(4,050,416)
Net increase in loans	(8,055,831)	(8,468,735)
Purchase of premises and equipment	<u>(184,245)</u>	<u>(66,891)</u>
Net cash used in investing activities	<u>(8,652,640)</u>	<u>(4,895,703)</u>
Cash flows from financing activities:		
Demand, interest bearing and savings deposits, net	25,342,622	8,577,976
Time deposits, net	(9,353,720)	637,987
Cash dividend paid	-	(515,469)
Proceeds from exercise of stock options	<u>132,092</u>	<u>11,240</u>
Net cash provided by financing activities	<u>16,120,994</u>	<u>8,711,734</u>
Increase in cash and cash equivalents	8,324,830	6,745,223
Cash and cash equivalents at beginning of period	<u>22,612,296</u>	<u>15,867,073</u>
Cash and cash equivalents at end of year	<u>\$ 30,937,126</u>	<u>\$ 22,612,296</u>

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RIVER VALLEY COMMUNITY BANK
STATEMENTS OF CASH FLOWS
Years Ended December 31, 2013 and 2012

	<u>2013</u>		<u>2012</u>
Supplemental cash flow information:			
Interest paid	\$ 223,992	\$	338,537
Income taxes paid	\$ 448,000	\$	591,000
Supplemental noncash disclosures:			
Transfers from loans to OREO	\$ -	\$	101,250

See accompanying notes to financial statements.

RIVER VALLEY COMMUNITY BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

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 Business Oversight (the "DBO") 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 also has a branch in Grass Valley, California. The Bank provides products and services to customers who are predominately small to middle-market businesses, professionals and not-for-profit organizations located in Sutter, Yuba, Nevada 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 U.S. accounting principles generally accepted in the United States of America requires management to make estimates and assumptions based on available information. 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.

Reclassifications: Some items in the prior year financial statements were reclassified to conform to the current presentation. Reclassifications had no effect on prior year net income or shareholders' equity.

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 two to eight years and are carried at cost.

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, net of tax.

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, 2013 and 2012, 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 at the trade date. 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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RIVER VALLEY COMMUNITY BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

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, net of deferred loan fees and costs, and an allowance for loan losses. 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 doubt, loans are placed on nonaccrual status and the accrual of interest income is suspended. Interest income on all loans is discontinued at the time the loan is 90 days delinquent unless the loan is well-secured and in process of collection. 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. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Loan origination fees, net of certain direct loan origination costs, are deferred and recognized as an adjustment of yield, to be amortized to interest income over the contractual term of the loan without anticipating prepayments.

Allowance for Loan Losses: The allowance for loan losses is an estimate of probable credit losses 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.

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.

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NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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.

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.

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NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 review 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 Business Oversight, 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.

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.

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RIVER VALLEY COMMUNITY BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 accrued interest receivable and other assets on the balance sheet.

Premises and Equipment: Premises and equipment are carried at cost, less accumulated depreciation. 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.

Bank Owned Life Insurance: The Bank has purchased life insurance policies on certain key executives. Bank owned life insurance is recorded at the amounts that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

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 is 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.

Derivatives: The Bank periodically enters into interest rate swap agreements, which management has designated as an instrument with no hedging designation (“stand-alone derivative”). For a fair value hedge, the gain or loss on the derivative, as well as the offsetting loss or gain on the hedged item, are recognized in current earnings as fair values change.

Net cash settlements on derivatives that do not qualify for hedge accounting are reported in noninterest income. Cash flows on hedges are classified in the cash flow statement the same as the cash flows of the items being hedged.

(Continued)

RIVER VALLEY COMMUNITY BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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.

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 are 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.

Retirement Plans: Employee 401(k) and profit sharing plan expense is the amount of matching contributions.

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.

(Continued)

RIVER VALLEY COMMUNITY BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Subsequent Events: The Bank reviewed all events occurring from December 31, 2013 through March 18, 2014, the date the financial statements were available to be issued and no subsequent events occurred requiring accrual or disclosure.

NOTE 2 – AVAILABLE-FOR-SALE INVESTMENT SECURITIES

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2013 and 2012 consisted of the following:

	2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government sponsored entities and agencies	\$ 2,136,419	\$ 28,156	\$ (18,761)	\$ 2,145,814
Obligations of states and political subdivisions	19,934,669	514,711	(479,501)	19,969,879
U.S. Government sponsored entities and agencies collateralized by mortgage obligations	6,363,172	32,421	(65,273)	6,330,320
Residential mortgage-backed securities	24,909,657	414,787	(123,808)	25,200,636
Other debt securities	8,290,094	28,311	(12,210)	8,306,195
	\$ 61,634,011	\$ 1,018,386	\$ (699,553)	\$ 61,952,844

	2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Government sponsored entities and agencies	\$ 861,373	\$ 40,552		\$ 901,925
Obligations of states and political subdivisions	18,578,581	1,177,114	\$ (35,238)	19,720,457
U.S. Government sponsored entities and agencies collateralized by mortgage obligations	6,129,844	39,465	(5,475)	6,163,834
Residential mortgage-backed securities	30,324,004	1,136,437	(24,214)	31,436,227
Other debt securities	6,287,159	130,958	(99,625)	6,318,492
	\$ 62,180,961	\$ 2,524,526	\$ (164,552)	\$ 64,540,935

Net unrealized gains on available-for-sale investment securities totaling \$318,833 and \$2,359,974 are recorded, net of \$127,533 and \$943,990 in tax liabilities as accumulated other comprehensive income within shareholders' equity at December 31, 2013 and 2012, respectively.

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RIVER VALLEY COMMUNITY BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

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

The proceeds from sales of securities and the associated gains and losses are listed below:

	<u>2013</u>	<u>2012</u>
Proceeds	\$ 2,376,416	\$ 2,639,878
Gross gains	75,059	136,174
Gross losses	(11,044)	-

The following table summarizes securities with unrealized losses at December 31, 2013 and 2012, aggregated by major security type and length of time in a continuous unrealized loss position:

	<u>Less Than 12 Months</u>		<u>12 Months or Longer</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>
<u>December 31, 2013</u>						
Available-for-sale:						
U.S. Government sponsored entities and agencies	\$ 1,449,381	\$ (18,761)	-	-	\$1,449,381	\$ (18,761)
Obligations of states and political subdivisions	4,129,498	(198,206)	\$3,936,357	\$ (281,294)	8,065,855	(479,500)
U.S. Government sponsored entities and agencies collateralized by mortgage obligations	1,987,212	(65,273)	-	-	1,987,212	(65,273)
Residential mortgage-backed securities	8,344,858	(123,809)	-	-	8,344,858	(123,809)
Other debt securities	<u>2,993,450</u>	<u>(6,550)</u>	<u>1,994,340</u>	<u>(5,660)</u>	<u>4,987,790</u>	<u>(12,210)</u>
Total available-for-sale	<u>\$18,904,399</u>	<u>\$ (412,599)</u>	<u>\$5,930,697</u>	<u>\$ (286,954)</u>	<u>\$24,835,096</u>	<u>\$ (699,553)</u>

	<u>Less Than 12 Months</u>		<u>12 Months or Longer</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>
<u>December 31, 2012</u>						
Available-for-sale:						
U.S. Government sponsored entities and agencies collateralized by mortgage obligations			\$ 904,401	\$ (5,475)	\$ 904,401	\$ (5,475)
Obligations of states and political subdivisions	\$2,905,886	\$ (35,238)			2,905,886	(35,238)
Residential mortgage-backed securities	1,793,490	(24,214)			1,793,490	(24,214)
Other debt securities			<u>3,400,375</u>	<u>(99,625)</u>	<u>3,400,375</u>	<u>(99,625)</u>
Total available-for-sale	<u>\$4,699,376</u>	<u>\$ (59,452)</u>	<u>\$4,304,776</u>	<u>\$ (105,101)</u>	<u>\$ 9,004,152</u>	<u>\$ (164,552)</u>

(Continued)

RIVER VALLEY COMMUNITY BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

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

As of December 31, 2013, the Bank's security portfolio consisted of 90 securities, 30 of which were in an unrealized loss position. The majority of unrealized losses are related to the Bank's investment in obligations of states and political subdivisions.

Unrealized losses for all securities 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.

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2013 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.

	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>
Within one year	\$ 441,942	\$ 439,940
After one year through five years	14,508,589	14,438,766
After five years through ten years	15,083,937	15,220,642
After ten years	<u>326,714</u>	<u>322,540</u>
	30,361,182	30,421,888
Investment securities not due at a single maturity date:		
U.S. Government sponsored entities and agencies collateralized by mortgage obligations	6,363,172	6,330,320
Residential mortgage-backed securities	<u>24,909,657</u>	<u>25,200,636</u>
	<u>\$ 61,634,011</u>	<u>\$ 61,952,844</u>

The Bank also had securities pledged with amortized costs totaling \$29,371,483 and \$24,793,364 and estimated fair values totaling approximately \$30,474,576 and \$26,118,510 for certain borrowing arrangements with the Federal Home Loan Bank of San Francisco as of December 31, 2013 and 2012, respectively (see Note 6).

(Continued)

RIVER VALLEY COMMUNITY BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 3 – LOANS

Outstanding loans at December 31, 2013 and 2012 are summarized below:

	<u>2013</u>	<u>2012</u>
Agriculture	\$ 3,941,648	\$ 2,672,828
Commercial	9,869,181	8,635,151
Commercial real estate	28,809,972	25,277,973
Real estate – other	20,635,421	18,561,967
Consumer and other	<u>159,373</u>	<u>208,095</u>
	63,415,595	55,356,014
Deferred loan fees, net	(98,670)	(119,432)
Allowance for loan losses	<u>(1,569,104)</u>	<u>(1,565,354)</u>
	<u>\$ 61,747,821</u>	<u>\$ 53,671,228</u>

Salaries and employee benefits totaling \$119,608 and \$95,252 have been deferred as direct loan origination costs for the years ended December 31, 2013 and 2012, respectively.

The following table presents the activity in the allowance for loan losses by portfolio segment for the years ending December 31, 2013 and 2012:

	December 31, 2013					
	<u>Agriculture</u>	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Real Estate – Other</u>	<u>Consumer</u>	<u>Total</u>
Allowance for loan losses:						
Beginning balance	\$ 25,606	\$ 159,256	\$ 909,915	\$ 466,648	\$ 3,929	\$ 1,565,354
Provision for loan losses	8,166	(21,335)	36,453	(21,501)	(1,783)	-
Loans charged-off	-	-	-	-	-	-
Recoveries	-	3,750	-	-	-	3,750
	<u>33,772</u>	<u>141,671</u>	<u>946,368</u>	<u>445,147</u>	<u>2,146</u>	<u>1,569,104</u>
Total ending allowance balance	<u>\$ 33,772</u>	<u>\$ 141,671</u>	<u>\$ 946,368</u>	<u>\$ 445,147</u>	<u>\$ 2,146</u>	<u>\$ 1,569,104</u>

	December 31, 2012					
	<u>Agriculture</u>	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Real Estate – Other</u>	<u>Consumer</u>	<u>Total</u>
Allowance for loan losses:						
Beginning balance	\$ 48,724	\$ 187,210	\$ 773,133	\$ 579,699	\$ 4,804	\$ 1,593,570
Provision for loan losses	(23,118)	(32,354)	169,398	(113,051)	(875)	-
Loans charged-off	-	-	(32,616)	-	-	(32,616)
Recoveries	-	4,400	-	-	-	4,400
	<u>25,606</u>	<u>159,256</u>	<u>909,915</u>	<u>466,648</u>	<u>3,929</u>	<u>1,565,354</u>
Total ending allowance balance	<u>\$ 25,606</u>	<u>\$ 159,256</u>	<u>\$ 909,915</u>	<u>\$ 466,648</u>	<u>\$ 3,929</u>	<u>\$ 1,565,354</u>

(Continued)

RIVER VALLEY COMMUNITY BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 3 – LOANS (Continued)

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, 2013 and 2012 by portfolio segment and by impairment methodology:

	December 31, 2013					Total
	Agriculture	Commercial	Commercial Real Estate	Real Estate – Other	Consumer	
<u>Allowance for Credit Losses</u>						
Ending balance: individually evaluated for impairment	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Ending balance: collectively evaluated for impairment	\$ 33,772	\$ 141,671	\$ 946,368	\$ 445,147	\$ 2,146	\$ 1,569,104
<u>Loans</u>						
Ending balance	\$ 3,941,648	\$ 9,869,181	\$ 28,809,972	\$ 20,635,421	\$ 159,373	\$ 63,415,595
Ending balance: individually evaluated for impairment	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Ending balance: collectively evaluated for impairment	\$ 3,941,648	\$ 9,869,181	\$ 28,809,972	\$ 20,635,421	\$ 159,373	\$ 63,415,595
	December 31, 2012					Total
	Agriculture	Commercial	Commercial Real Estate	Real Estate – Other	Consumer	
<u>Allowance for Credit Losses</u>						
Ending balance: individually evaluated for impairment	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Ending balance: collectively evaluated for impairment	\$ 25,606	\$ 159,256	\$ 909,915	\$ 466,648	\$ 3,929	\$ 1,565,354
<u>Loans</u>						
Ending balance	\$ 2,672,828	\$ 8,635,151	\$ 25,277,973	\$ 18,561,967	\$ 208,095	\$ 55,356,014
Ending balance: individually evaluated for impairment	\$ -	\$ -	\$ 735,516	\$ -	\$ -	\$ 735,516
Ending balance: collectively evaluated for impairment	\$ 2,672,828	\$ 8,635,151	\$ 24,542,457	\$ 18,561,967	\$ 208,095	\$ 54,620,498

(Continued)

RIVER VALLEY COMMUNITY BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 3 – LOANS (Continued)

The following table presents the loan portfolio by class allocated by management's internal risk ratings at December 31, 2013 and 2012:

	December 31, 2013					
	Credit Quality Indicators					
	Credit Risk Profile by Internally Assigned Grade					
	<u>Agriculture</u>	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Real Estate – Other</u>	<u>Consumer</u>	<u>Total</u>
Grade:						
Pass	\$ 3,941,648	\$ 9,551,469	\$ 26,230,116	\$ 20,537,388	\$ 159,373	\$ 60,419,994
Special Mention	-	-	1,141,770	98,033	-	1,239,803
Substandard	-	317,712	1,438,086	-	-	1,755,798
Doubtful	-	-	-	-	-	-
Total	<u>\$ 3,941,648</u>	<u>\$ 9,869,181</u>	<u>\$ 28,809,972</u>	<u>\$ 20,635,421</u>	<u>\$ 159,373</u>	<u>\$ 63,415,595</u>

	December 31, 2012					
	Credit Quality Indicators					
	Credit Risk Profile by Internally Assigned Grade					
	<u>Agriculture</u>	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Real Estate – Other</u>	<u>Consumer</u>	<u>Total</u>
Grade:						
Pass	\$ 2,286,252	\$ 8,138,323	\$ 21,855,780	\$ 17,676,596	\$ 206,786	\$ 50,163,737
Special Mention	386,576	92,125	1,903,392	-	-	2,382,093
Substandard	-	404,703	1,518,801	885,371	1,309	2,810,184
Doubtful	-	-	-	-	-	-
Total	<u>\$ 2,672,828</u>	<u>\$ 8,635,151</u>	<u>\$ 25,277,973</u>	<u>\$ 18,561,967</u>	<u>\$ 208,095</u>	<u>\$ 55,356,014</u>

The following table presents an aging analysis of the loan portfolio by class and the time past due at December 31, 2013:

	<u>30-89 Days Past Due</u>	<u>90 Days and Still Accruing</u>	<u>Nonaccrual</u>	<u>Total Past Due</u>	<u>Current</u>	<u>Total</u>
Agriculture	-	-	-	-	\$ 3,941,648	\$ 3,941,648
Commercial	-	-	-	-	9,869,181	9,869,181
Commercial real estate	-	-	-	-	28,809,972	28,809,972
Real estate – other	-	-	-	-	20,635,421	20,635,421
Consumer	\$ 350	-	-	\$ 350	159,023	159,373
Total	<u>\$ 350</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 350</u>	<u>\$ 63,415,245</u>	<u>\$ 63,415,595</u>

There were no past due loans at December 31, 2012.

(Continued)

RIVER VALLEY COMMUNITY BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 3 – LOANS (Continued)

The following table shows information related to impaired loans by class at and for the year ended December 31, 2012:

	December 31, 2012					
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
Commercial real estate	\$ 735,516	\$ 735,516	-	\$ 852,487	\$ 52,693	-

There were no impaired loans at December 31, 2013.

No specific reserves were allocated to customers whose loan terms have been modified in troubled debt restructurings as of December 31, 2013 and 2012.

The Bank has not committed to lend any additional amounts as of December 31, 2013 and 2012 to customers with outstanding loans that are classified as troubled debt restructurings. During the years ended December 31, 2013 and 2012, there were no modifications that were determined to be troubled debt restructurings.

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.

NOTE 4 – PREMISES AND EQUIPMENT

Premises and equipment at December 31, 2013 and 2012 consisted of the following:

	<u>2013</u>	<u>2012</u>
Land	\$ 774,631	\$ 774,631
Premises	1,550,724	1,550,724
Furniture, fixtures and equipment	446,802	317,695
Leaseholder improvements	18,526	-
	2,790,683	2,643,050
Less accumulated depreciation	(519,880)	(435,432)
	\$ 2,270,803	\$ 2,207,618

Depreciation included in occupancy and equipment expense totaled \$121,060 and \$91,119 for the years ended December 31, 2013 and 2012, respectively.

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RIVER VALLEY COMMUNITY BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 5 – INTEREST-BEARING DEPOSITS

Interest-bearing deposits consisted of the following:

	<u>2013</u>	<u>2012</u>
Savings	\$ 1,988,834	\$ 1,181,709
Money market	69,604,356	62,822,880
Interest-bearing demand accounts	17,147,196	11,168,759
Time, under \$100,000	2,638,732	2,707,343
Time, \$100,000 or more	<u>8,034,147</u>	<u>17,319,256</u>
	<u>\$ 99,413,265</u>	<u>\$ 95,199,947</u>

Aggregate annual maturities of time deposits are as follows:

<u>Years Ending December 31,</u>	
2014	\$ 9,208,346
2015	962,916
2016	87,617
2017	203,916
2018	<u>210,084</u>
	<u>\$ 10,672,879</u>

Interest expense recognized on interest-bearing deposits for the years ended December 31, 2013 and 2012 consisted of the following:

	<u>2013</u>	<u>2012</u>
Savings	\$ 484	\$ 557
Money market	131,851	175,771
Interest-bearing demand accounts	5,612	8,079
Time, \$100,000 or more	10,560	133,790
Other time	<u>64,224</u>	<u>16,729</u>
	<u>\$ 212,731</u>	<u>\$ 334,926</u>

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, 2013 and 2012, 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, 2013 and 2012, the fair value of investment securities pledged was approximately \$30,474,576 and \$26,118,510, respectively, and the amount of borrowings available under this arrangement was approximately \$28,811,527 and \$24,793,364. As of December 31, 2013 and 2012, the Bank did not have borrowings outstanding with the FHLB.

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RIVER VALLEY COMMUNITY BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 7 – INCOME TAXES

Income taxes for the years ended December 31, 2013 and 2012 consisted of the following:

	<u>2013</u>	<u>2012</u>
Current	\$ 358,932	\$ 678,097
Deferred	<u>58,700</u>	<u>(32,800)</u>
Income tax expense	<u>\$ 417,632</u>	<u>\$ 645,297</u>

Deferred tax assets (liabilities) at December 31, 2013 and 2012 consisted of the following:

	<u>2013</u>	<u>2012</u>
Deferred tax assets:		
Organization costs	\$ 67,400	\$ 76,500
Allowance for loan losses	665,400	673,100
Share-based payments	136,200	129,000
Other	<u>-</u>	<u>22,400</u>
Total deferred tax assets	<u>869,000</u>	<u>901,000</u>
Deferred tax liabilities:		
Accrual to cash conversion	(164,900)	(115,800)
Future liability of state deferred tax asset	(20,400)	(11,600)
Unrealized gain on available-for-sale investment securities	(127,500)	(944,000)
Other	<u>(59,600)</u>	<u>(87,100)</u>
Total deferred tax liabilities	<u>(372,400)</u>	<u>(1,158,500)</u>
Net deferred tax liability	<u>\$ 496,600</u>	<u>\$ (257,500)</u>

(Continued)

RIVER VALLEY COMMUNITY BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 7 – INCOME TAXES (Continued)

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,			
	2013		2012	
	<u>Amount</u>	<u>Rate %</u>	<u>Amount</u>	<u>Rate %</u>
Federal income tax expense at statutory rates	\$ 565,798	34.0	\$ 712,763	34.0
State franchise tax expense, net of Federal tax benefit	119,057	7.1	134,499	6.4
Tax exempt investment security income, net	(209,860)	(12.6)	(180,000)	(8.6)
Non-deductible stock option expense	32,629	2.0	27,617	1.3
Bank owned life insurance	(45,446)	(2.7)	(20,748)	(1.0)
Enterprise zone State tax credits	(51,456)	(3.1)	(35,799)	(1.7)
Other	<u>6,910</u>	<u>0.4</u>	<u>6,965</u>	<u>0.4</u>
Total income tax expense	<u>\$ 417,632</u>	<u>25.1</u>	<u>\$ 645,297</u>	<u>30.8</u>

The Bank is subject to U.S. federal income tax as well as California state franchise tax. Federal tax returns for 2012, 2011 and 2010 are currently open for examination. California state franchise tax returns for 2012, 2011, 2010 and 2009 are currently open for examination. The Bank currently has no tax returns under examination.

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 at December 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Commitments to extend credit	\$ 22,087,617	\$ 11,318,142

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.

(Continued)

NOTE 8 – COMMITMENTS AND CONTINGENCIES (Continued)

Commercial loan commitments represent approximately 50% 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 10% 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 28% 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 12% of total commitments and are generally secured by residential real estate and have both variable and fixed interest rates.

Concentrations of Credit Risk: The Bank grants real estate mortgage, real estate construction and commercial loans to customers in Sutter, Yuba, Nevada 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, 2013.

In management's judgment, a concentration of loans exists in real estate related loans with approximately 79% 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 represents 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 22% of the Bank's deposits at December 31, 2013. These relationships are primarily with related parties (see Note 12). 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, 2013.

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.

(Continued)

RIVER VALLEY COMMUNITY BANK
NOTES TO FINANCIAL STATEMENTS
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NOTE 9 – SHARE-BASED PAYMENTS (Continued)

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, 2013 and 2012.

A summary of option activity under the Plan for the year ended December 31, 2013 is presented below:

<u>Options</u>	<u>Shares</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Remaining Contractual Term</u>
Outstanding at beginning of year	340,250	\$ 8.95	
Granted	13,500	\$ 15.00	
Forfeited	(3,825)	\$ 9.90	
Exercised	<u>(16,238)</u>	<u>\$ 8.13</u>	
Outstanding at December 31, 2013	<u>333,687</u>	<u>\$ 9.24</u>	<u>4.27 years</u>
Exercisable at December 31, 2013	<u>261,562</u>	<u>\$ 8.53</u>	<u>3.23 years</u>

Information related to the stock option plan during each year follows:

	<u>2013</u>	<u>2012</u>
Intrinsic value of options exercised	\$ 166,006	\$ 10,710
Cash received from options exercised	132,092	11,240
Tax benefit realized from option exercise	-	-

As of December 31, 2013, the unrecognized compensation cost related to non-vested stock option awards totaled \$95,161. That cost is expected to be amortized on a straight-line basis over a weighted average period of five years and will be adjusted for subsequent changes in estimated forfeitures.

The following stock option information is for years ended December 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Weighted average grant date fair value per share of options granted	6.59	\$4.23
Significant fair value assumptions:		
Expected term in years	6.5 years	6.5 years
Expected annual volatility	41.34%	39.15%
Expected annual dividend yield	N/A	N/A
Risk-free interest rate	1.21%	1.30%
Total compensation cost (included in salaries and employee benefits and other expense)	\$ 95,161	\$ 80,274

(Continued)

RIVER VALLEY COMMUNITY BANK
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NOTE 10 – SHAREHOLDERS' EQUITY

Earnings per share: A reconciliation of the numerators and denominators of the basic and diluted earnings per share computations for the years ended December 31, 2013 and 2012 is as follows.

	<u>Net Income Available to Common Shareholder</u>	<u>Weighted Average Number of Shares Outstanding</u>	<u>Common Share Amount</u>
<u>December 31, 2013</u>			
Basic earnings per share	\$ 1,246,480	1,722,539	\$ 0.72
Effect of dilutive stock options and restricted shares		<u>144,780</u>	
Diluted earnings per share	\$ 1,246,480	<u>1,867,319</u>	0.67
<u>December 31 2012</u>			
Basic earnings per share	\$ 1,451,066	1,717,220	0.85
Effect of dilutive stock options and restricted shares		<u>113,382</u>	
Diluted earnings per share	\$ 1,451,066	<u>1,830,602</u>	\$ 0.79

Shares of common stock issuable under stock options for which the exercise prices are greater than average market prices are not included in the computation of diluted earnings per share due to their antidilutive effect. There were no options excluded from computation of diluted earnings per share for the year and ended December 31, 2013. There were 1,250 options excluded from the computation of diluted earnings per share for the year ended December 31, 2012.

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, 2013, retained earnings of \$3,438,320 were free of such restrictions.

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, 2013.

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RIVER VALLEY COMMUNITY BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 10 – SHAREHOLDERS' EQUITY (Continued)

As of December 31, 2013 and 2012, the most recent notification from the FDIC 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 below. There are no conditions or events since that notification that management believes have changed the Bank's category.

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.

	<u>2013</u>		<u>2012</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
<u>Leverage Ratio</u>				
River Valley Community Bank	\$ 19,575,000	12.2%	\$ 18,101,000	12.6%
Minimum requirement for "Well-Capitalized" institution	\$ 7,993,000	5.0%	\$ 7,179,400	5.0%
Minimum regulatory requirement	\$ 6,394,400	4.0%	\$ 5,743,500	4.0%
<u>Tier 1 Risk-Based Capital Ratio</u>				
River Valley Community Bank	\$ 19,575,000	19.1%	\$ 18,101,000	21.2%
Minimum requirement for "Well-Capitalized" institution	\$ 6,148,300	6.0%	\$ 5,124,400	6.0%
Minimum regulatory requirement	\$ 4,098,900	4.0%	\$ 3,416,200	4.0%
<u>Total Risk-Based Capital Ratio</u>				
River Valley Community Bank	\$ 20,860,018	20.4%	\$ 19,175,000	22.5%
Minimum requirement for "Well-Capitalized" institution	\$ 10,247,200	10.0%	\$ 8,540,600	10.0%
Minimum regulatory requirement	\$ 8,197,800	8.0%	\$ 6,832,500	8.0%

NOTE 11 – DERIVATIVES

The Bank utilizes interest rate swap agreements as part of its asset liability management strategy to help manage its interest rate risk position. The notional amount of the interest rate swaps does not represent amounts exchanged by the parties. The amount exchanged is determined by reference to the notional amount and the other terms of the individual interest rate swap agreements.

(Continued)

RIVER VALLEY COMMUNITY BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 11 – DERIVATIVES (Continued)

Interest Rate Swaps: In 2013, the Bank entered into one new interest rate swap agreement with a notional amount of \$497,693. The bank also has two preexisting swap agreements that were entered into during 2012 with a combined current notional amount of \$1,729,375. Management has chosen to not apply hedge accounting treatment to these interest rate swap agreements, and therefore changes in fair value are reported in current year earnings. At December 31, 2013, summary information about these interest-rate swaps is as follows:

Notional amounts	\$ 2,227,068
Weighted average pay rates	5.19%
Weighted average receive rates	5.19%
Weighted average maturity	13 years
Fair value of combined interest rate swaps	\$ 162,143

The fair value of the combined interest rate swaps at December 31, 2013 are reflected in other assets and other liabilities with changes in fair value recorded in non-interest income.

NOTE 12 – 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, 2013:

Beginning balance	\$ 3,126,340
Disbursements	3,205,000
Amounts repaid	<u>(1,657,769)</u>
Balance, December 31, 2013	<u>\$ 4,673,571</u>
Undisbursed commitments to related parties, December 31, 2013	<u>\$ 1,707,860</u>

At December 31, 2013 and 2012 the Bank's deposits from related parties totaled \$32,787,239 or 22% and \$41,442,110 or 32% of the Bank's total deposits, respectively. These related parties include Directors, executive officers and their affiliates. These depositors have strong relationships and connections with the Bank. As a result, management believes these circumstances mitigate the risk of unexpected volatility of their deposits.

NOTE 13 – 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. Contributions of \$38,027 and \$35,015 were made for the years ended December 31, 2013 and 2012, respectively.

(Continued)

NOTE 14 – FAIR VALUE

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (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. There are three levels of inputs that may be used to measure fair values:

Level 1 – Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2 – Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 – Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Bank used the following methods and significant assumptions to estimate fair value:

Investment Securities: Fair values for investment securities are determined by quotes received from an independent pricing service using matrix pricing, which is a mathematical technique widely used in the industry to value securities without relying exclusively on quoted market prices for the specific securities, but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2).

Derivatives: The fair values of derivatives are based on valuation models using observable market data as of the measurement date (Level 2).

Impaired Loans: The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

Other Real Estate Owned: Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. Fair value is commonly based on recent real estate appraisals which are updated no less frequently than annually. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Real estate owned properties are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

(Continued)

RIVER VALLEY COMMUNITY BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 14 – FAIR VALUE (Continued)

Assets and liabilities measured at fair value on a recurring basis are summarized below:

	Fair Value Measurements at December 31, 2013 Using:			<u>Total</u>
	Quoted Prices in Active Markets for Identical Assets <u>(Level 1)</u>	Significant Other Observable Inputs <u>(Level 2)</u>	Significant Unobservable Inputs <u>(Level 3)</u>	
Financial assets				
Investment securities available-for-sale				
U.S. government- sponsored entities and agencies	\$ -	\$ 2,145,814	\$ -	\$ 2,145,814
Obligations of States and political subdivisions	-	6,330,320	-	6,330,320
U.S. government sponsored entities and agencies collateralized by mortgage obligations	-	19,969,879	-	19,969,879
Residential mortgage-backed securities	-	25,200,636	-	25,200,636
 Other debt securities	 -	 8,306,195	 -	 8,306,195
 Total investment securities available- for-sale	 <u>\$ -</u>	 <u>\$ 61,952,844</u>	 <u>\$ -</u>	 <u>\$ 61,952,844</u>
 Derivatives	 <u>\$ -</u>	 <u>\$ 162,143</u>	 <u>\$ -</u>	 <u>\$ 162,143</u>
 Financial liabilities derivatives	 <u>\$ -</u>	 <u>\$ 162,143</u>	 <u>\$ -</u>	 <u>\$ 162,143</u>

(Continued)

RIVER VALLEY COMMUNITY BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 14 – FAIR VALUE (Continued)

	Fair Value Measurements at December 31, 2012 Using:			<u>Total</u>
	Quoted Prices in Active Markets for Identical Assets <u>(Level 1)</u>	Significant Other Observable Inputs <u>(Level 2)</u>	Significant Unobservable Inputs <u>(Level 3)</u>	
Financial assets				
Investment securities available-for-sale				
U.S. government- sponsored entities and agencies	\$ -	\$ 901,905	\$ -	\$ 901,905
Obligations of States and political subdivisions	-	19,720,457	-	19,720,457
U.S. government sponsored entities and agencies collateralized by mortgage obligations	-	6,163,834	-	6,163,834
Residential mortgage-backed securities	-	31,436,227	-	31,436,227
Other debt securities	-	<u>6,318,492</u>	-	<u>6,318,492</u>
Total investment securities available- for-sale	<u>\$ -</u>	<u>\$ 65,540,935</u>	<u>\$ -</u>	<u>\$ 65,540,935</u>
Derivatives	<u>\$ -</u>	<u>\$ 31,835</u>	<u>\$ -</u>	<u>\$ 31,835</u>
Financial liabilities derivatives	<u>\$ -</u>	<u>\$ 31,835</u>	<u>\$ -</u>	<u>\$ 31,835</u>

There were no assets measured at fair value on a non-recurring at December 31, 2013.

Assets measured at fair value on a non-recurring basis at December 31, 2012 are summarized below:

	Fair Value Measurements at December 31, 2012 Using:			<u>Total Losses</u>
	Quoted Prices in Active Markets for Identical Assets <u>(Level 1)</u>	Significant Other Observable Inputs <u>(Level 2)</u>	Significant Unobservable Inputs <u>(Level 3)</u>	
Other real estate owned, net: Commercial real estate	\$ -	-	\$ 101,250	\$ (32,616)

(Continued)

RIVER VALLEY COMMUNITY BANK
NOTES TO FINANCIAL STATEMENTS
December 31, 2013 and 2012

NOTE 14 – FAIR VALUE (Continued)

The carrying amounts and estimated fair values of financial instruments, at December 31, 2013 and December 31, 2012 are as follows:

	<u>Carrying Amount</u>	<u>Fair Value Measurements at December 31, 2013 Using:</u>			
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Financial assets:					
Cash and due from banks	\$ 7,162,817	\$ 7,162,817	\$ -	\$ -	\$ 7,162,817
Fed funds sold	23,774,309	-	23,774,309	-	23,774,309
Interests bearing deposits in banks	3,231,000	-	3,231,000	-	3,231,000
Securities available-for-sale	61,952,844	-	61,952,844	-	61,952,844
Federal Home Loan Bank stock	671,200	N/A	N/A	N/A	N/A
Loans, net	61,747,821	-	-	63,708,439	63,708,439
Derivatives	162,143	-	162,143	-	-
Accrued interest receivable	566,602	-	370,802	195,800	566,602
Financial liabilities:					
Deposits	\$ 146,365,065	\$ 135,692,185	\$ 10,673,101	\$ -	\$ 146,365,286
Derivatives	162,143	-	162,143	-	162,143
Accrued interest payable	7,907	1,797	6,110	-	7,907

	<u>Carrying Amount</u>	<u>Fair Value Measurements at December 31, 2012 Using:</u>			
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Financial assets:					
Cash and due from banks	\$ 5,894,250	\$ 5,894,250	\$ -	\$ -	\$ 5,894,250
Fed funds sold	16,718,046	-	16,718,046	-	16,718,046
Interests bearing deposits in banks	2,486,000	-	2,486,000	-	2,486,000
Securities available-for-sale	64,540,935	-	64,540,935	-	64,540,935
Federal Home Loan Bank stock	755,100	N/A	N/A	N/A	N/A
Loans, net	53,671,228	-	-	55,696,579	55,696,579
Derivatives	31,835	-	31,835	-	31,835
Accrued interest receivable	529,074	-	350,526	178,548	529,074
Financial liabilities:					
Deposits	\$ 130,376,163	\$ 110,349,564	\$ 20,075,567	\$ -	\$ 130,425,131
Derivatives	31,835	-	31,835	-	31,835
Accrued interest payable	19,168	1,888	17,280	-	19,168

The methods and assumptions, not previously presented, used to estimate fair values are described as follows:

Cash and Cash Equivalents

The carrying amounts of cash and short-term instruments approximate fair values and are classified as either Level 1 or Level 2.

(Continued)

NOTE 14 – FAIR VALUE (Continued)

FHLB Stock

It is not practical to determine the fair value of FHLB stock due to restrictions placed on its transferability.

Loans

Fair values of loans are estimated as follows: For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values resulting in a Level 3 classification. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality resulting in a Level 3 classification. Impaired loans are valued at the lower of cost or fair value as described previously. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.

Deposits

The fair values disclosed for demand deposits (e.g., interest and non-interest checking, savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amount) resulting in a Level 1 classification. The carrying amounts of variable rate, fixed-term money market accounts and certificates of deposit approximate their fair values at the reporting date resulting in a Level 1 classification. Fair values for fixed rate certificates of deposit are estimated using a discounted cash flows calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits resulting in a Level 2 classification.

Accrued Interest Receivable/Payable

The carrying amounts of accrued interest approximate fair value resulting in a Level 1, Level 2 or Level 3 classification.