

**COMMUNITY FIRST  
BANCORPORATION, INC.  
AND SUBSIDIARY  
KENNEWICK, WA**

**AUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**AND OTHER FINANCIAL INFORMATION**

**DECEMBER 31, 2011 AND 2010**

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NOTE: This annual report serves as the Bank's annual disclosure statement under requirements of the Federal Deposit Insurance Corporation (FDIC). This statement has not been reviewed, or confirmed for accuracy or relevance, by the FDIC.



## INDEPENDENT AUDITOR'S REPORT

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The Board of Directors and Shareholders  
of Community First Bancorporation, Inc.  
Kennewick, WA

We have audited the accompanying consolidated balance sheets of Community First Bancorporation, Inc. and Subsidiary as of December 31, 2011 and 2010 and the related statements of income, changes in shareholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Companies' management. 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 audits 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 audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Community First Bancorporation, Inc. and Subsidiary as of December 31, 2011 and 2010 and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The other financial information on pages 40-46 is presented for the purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the other financial information is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

*Stovall, Grandey & Allen, LLP*

STOVALL, GRANDEY & ALLEN, L.L.P.  
Fort Worth, Texas  
March 6, 2012

**COMMUNITY FIRST BANCORPORATION, INC. AND SUBSIDIARY**  
**CONSOLIDATED BALANCE SHEETS**  
**DECEMBER 31, 2011 AND 2010**  
(Dollars in Thousands)

	<b>2011</b>	<b>2010</b>
<b>ASSETS</b>		
Cash and cash equivalents:		
Cash and due from banks - Note 3	\$ 1,061	\$ 938
Interest-bearing deposits in financial institutions maturing in less than three months	36,661	10,979
Total cash and cash equivalents	37,722	11,917
Interest-bearing deposits in financial institutions maturing in more than three months	15,900	13,770
Investment securities - Note 4	20,680	25,362
Federal Home Loan Bank stock, at cost - Note 2	229	229
Loans held-for-sale - Note 5	261	417
Loans, net of allowance for loan losses - Note 5	116,672	112,274
Bank premises and equipment, net of accumulated depreciation - Note 6	2,902	2,991
Bank-owned life insurance	3,774	2,172
Accrued interest receivable	712	563
Goodwill	489	489
Other assets	472	516
<b>Total Assets</b>	<b>\$ 199,813</b>	<b>\$ 170,700</b>
 <b>LIABILITIES</b>		
Deposits - Note 7	\$ 179,628	\$ 151,361
Short-term borrowings - Note 8	-	450
Advances from Federal Home Loan Bank - Note 9	500	500
Other long-term borrowings - Note 9	2,164	2,786
Other liabilities:		
Accrued interest payable	105	155
Accrued expenses and other liabilities	224	172
Total other liabilities	329	327
<b>Total Liabilities</b>	<b>182,621</b>	<b>155,424</b>
 Commitments and contingencies - Notes 6, 11, 12, 13, 14 and 15		
 <b>SHAREHOLDERS' EQUITY</b>		
Common stock, \$1 par value:		
Authorized - 1,000,000 shares		
Issued and outstanding - 443,705 and 441,602 shares at December 31, 2011 and 2010, respectively	444	442
Additional paid-in capital	10,412	10,344
Retained earnings	6,112	4,472
Accumulated other comprehensive income	224	18
<b>Total Shareholders' Equity</b>	<b>17,192</b>	<b>15,276</b>
<b>Total Liabilities and Shareholders' Equity</b>	<b>\$ 199,813</b>	<b>\$ 170,700</b>

The accompanying notes are an integral part of these financial statements.

**COMMUNITY FIRST BANCORPORATION, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF INCOME**  
**FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010**  
(Dollars in Thousands, except for per share amounts)

	<u>2011</u>	<u>2010</u>
<b>Interest income</b>		
Interest and fees on loans	\$ 7,829	\$ 7,929
Interest on investment securities	405	274
Interest on federal funds sold and interest-bearing deposits with financial institutions	179	143
Total interest income	<u>8,413</u>	<u>8,346</u>
<b>Interest expense</b>		
On deposits	736	933
On borrowed funds	134	158
Total interest expense	<u>870</u>	<u>1,091</u>
Net interest income	7,543	7,255
Provision for loan losses - Note 5	98	301
Net interest income after provision for loan losses	<u>7,445</u>	<u>6,954</u>
<b>Non-interest income</b>		
Service charges and fees on deposit accounts	316	263
Mortgage broker fees	125	157
Earnings on bank-owned life insurance	102	72
Gain on sales of investment securities	82	-
Net gain on sales of loans	191	132
Other	312	256
Total non-interest income	<u>1,128</u>	<u>880</u>
<b>Non-interest expense</b>		
Salaries and employee benefits	3,537	3,121
Occupancy	368	373
Furniture and equipment	159	166
Data processing	291	260
Professional fees	254	343
Other operating expenses	906	885
Total non-interest expense	<u>5,515</u>	<u>5,148</u>
<b>Net Income</b>	<u>\$ 3,058</u>	<u>\$ 2,686</u>
<b>Basic earnings per share of common stock</b>	\$ 6.90	\$ 6.11
<b>Average shares of common stock outstanding</b>	443,170	439,707

The accompanying notes are an integral part of these financial statements.

**COMMUNITY FIRST BANCORPORATION, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**  
**FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010**  
(Dollars in Thousands)

	<u>Common Stock</u>	<u>Additional Paid-In Capital</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income</u>	<u>Total</u>
Balance at January 1, 2010	\$ 436	\$ 10,190	\$ 3,069	\$ 138	\$ 13,833
Exercise of stock options	5	130			135
Stock option compensation expense		15			15
Restricted stock compensation expense	1	9			10
Net income for the year ended December 31, 2010			2,686		2,686
Unrealized loss on available-for- sale securities				(120)	(120)
Comprehensive income					2,566
Dividends paid - \$2.92 per share			(1,283)		(1,283)
<b>Balance at December 31, 2010</b>	<b>442</b>	<b>10,344</b>	<b>4,472</b>	<b>18</b>	<b>15,276</b>
Exercise of stock options	1	37			38
Stock option compensation expense		7			7
Restricted stock compensation expense	1	24			25
Net income for the year ended December 31, 2011			3,058		3,058
Unrealized gain on available-for- sale securities				206	206
Comprehensive income					3,264
Dividends paid - \$3.20 per share			(1,418)		(1,418)
<b>Balance at December 31, 2011</b>	<b>\$ 444</b>	<b>\$ 10,412</b>	<b>\$ 6,112</b>	<b>\$ 224</b>	<b>\$ 17,192</b>

The accompanying notes are an integral part of these financial statements.

**COMMUNITY FIRST BANCORPORATION, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010**  
(Dollars in Thousands)

	<b>2011</b>	<b>2010</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 3,058	\$ 2,686
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	236	264
Provision for loan losses	98	301
Net amortization on investment securities	264	163
Stock option compensation expense	7	15
Restricted stock compensation expense	25	10
Earnings on bank-owned life insurance	(102)	(72)
Gain on sales of investment securities	(82)	-
Originations of loans held-for-sale	(15,294)	(11,853)
Proceeds from sales of loans held-for-sale	15,641	11,568
Net gain on sales of loans	(191)	(132)
(Increase) decrease in accrued interest receivable	(149)	51
Increase (decrease) in accrued interest payable	(50)	21
Other	33	120
Total adjustments	436	456
<b>Net Cash Provided by Operating Activities</b>	<b>3,494</b>	<b>3,142</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Increase in interest-bearing deposits in financial institutions maturing in more than three months	(2,130)	(9,270)
Purchases of investment securities:		
Available-for-sale	(24,105)	(34,025)
Proceeds from maturities and calls of investment securities:		
Available-for-sale	24,110	19,950
Proceeds from sales of investment securities:		
Available-for-sale	2,250	-
Proceeds from principal paydowns on investment securities:		
Available-for-sale	2,480	1,865
Net increase in loans made to customers	(4,496)	(2,668)
Purchases of premises and equipment	(113)	(16)
Purchases of bank-owned life insurance	(1,500)	(2,100)
<b>Net Cash Used by Investing Activities</b>	<b>\$ (3,504)</b>	<b>\$ (26,264)</b>

The accompanying notes are an integral part of these financial statements.

**COMMUNITY FIRST BANCORPORATION, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS, Continued**  
**FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010**  
(Dollars in Thousands)

	<b>2011</b>	<b>2010</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net increase in demand deposits, interest-bearing transaction accounts and savings	\$ 26,241	\$ 30,251
Net increase (decrease) in time deposits	2,026	(226)
Net increase (decrease) in short-term borrowings	(450)	75
Proceeds from other long-term borrowings	2,164	-
Principal payments on other long-term borrowings	(2,786)	(214)
Proceeds from stock options exercised	38	135
Dividends paid	(1,418)	(1,283)
<b>Net Cash Provided by Financing Activities</b>	<b>25,815</b>	<b>28,738</b>
<b>Net increase in cash and cash equivalents</b>	<b>25,805</b>	<b>5,616</b>
<b>Cash and cash equivalents at beginning of year</b>	<b>11,917</b>	<b>6,301</b>
<b>Cash and cash equivalents at end of year</b>	<b>\$ 37,722</b>	<b>\$ 11,917</b>
 <b>SUPPLEMENTAL SCHEDULE OF OPERATING AND INVESTING ACTIVITIES:</b>		
Interest paid	\$ 920	\$ 1,070



**COMMUNITY FIRST BANCORPORATION, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2011 AND 2010**

**Note 1      History**

Community First Bancorporation, Inc. was formed August 6, 2004 to serve as a bank holding company. The Corporation was activated January 1, 2005, when Community First Bancorporation, Inc. and Community First Bank entered into a Share Exchange Agreement in order to effect the acquisition of 100 percent of the issued and outstanding common stock of the Bank. Each eligible Bank Shareholder received one share of Corporation stock in exchange for each share of Bank stock owned.

In order to effect a conversion to a Subchapter S corporation, there was a 1-for-1,000 reverse stock split. During 2005, Community First Merger Corporation, Inc. was formed in order to effectuate the Subchapter S conversion. Effective January 1, 2006, Community First Bancorporation, Inc. and Community First Merger Corporation, Inc., a Subchapter S corporation, merged. After this merger, a 1,000-for-1 stock split occurred, which restored the number of shares to the original amounts prior to the reverse stock split.

**Note 2      Summary of Significant Accounting Policies**

The consolidated financial statements of the Corporation include its accounts and those of its one hundred percent (100%) owned subsidiary, Community First Bank. The accounting and reporting policies of both entities are in accordance with accounting principles generally accepted in the United States of America. All dollar amounts, except per share information, are stated in thousands.

Principles of Consolidation

In the consolidated financial statements, all significant intercompany accounts and transactions have been eliminated upon consolidation.

Nature of Operations

Community First Bancorporation, Inc. is a bank holding company whose principal activity is the ownership and management of its wholly-owned subsidiary, Community First Bank. Community First Bank operates four offices in Kennewick, Connell, Pasco and Richland, Washington. Community First Bank provides loan services to and accepts deposits from customers, who are predominately small- and middle-market businesses and middle-income individuals, in Southeastern Washington State. Funding sources are deposits from customers, public entities and borrowings from various sources. The Bank operates under a state bank charter and provides full banking services.

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 that affect the reported amounts of assets and liabilities and disclosure of contingent 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 those estimates.

**COMMUNITY FIRST BANCORPORATION, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2011 AND 2010**

**Note 2      Summary of Significant Accounting Policies, continued**

Estimates, continued

The determination of the adequacy of the allowance for loan losses is based on estimates that are particularly susceptible to significant changes in the economic environment and market conditions. In connection with the determination of the estimated losses on loans, management obtains independent appraisals for significant collateral.

The Corporation's loans are generally secured by specific items of collateral including real property, consumer assets and business assets. Although the Corporation has a diversified loan portfolio, a substantial portion of its debtors' ability to honor their contracts is dependent on local economic conditions.

While management uses available information to recognize losses on loans, further reductions in the carrying amounts of loans may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the estimated losses on loans. Such agencies may require the Corporation to recognize additional losses based on their judgments about information available to them at the time of their examination. Because of these factors, it is reasonably possible that the estimated losses on loans may change materially in the near term. However, the amount of the change that is reasonably possible cannot be estimated.

Cash and Cash Equivalents and Cash Flows

For the purpose of presentation in the Statements of Cash Flows, cash and cash equivalents are defined as those amounts included in cash and amounts due from depository institutions, interest-bearing deposits maturing in three months or less and federal funds sold. The Companies report net cash flows from customer loan transactions, deposit transactions and short-term borrowings.

Investment Securities

The Corporation accounts for investment securities according to authoritative guidance issued by the Financial Accounting Standards Board (FASB). Under the provisions of the FASB authoritative guidance, debt securities that management has the ability and intent to hold to maturity are classified as held-to-maturity and carried at amortized cost. The amortization of premiums and accretion of discounts are recognized in interest income using methods approximating the interest method over the period to maturity.

Debt securities not classified as held-to-maturity are classified as available-for-sale. Securities available-for-sale are carried at fair value with unrealized gains and losses reported in other comprehensive income. Realized gains (losses) on securities available-for-sale are included in other income and, when applicable, are reported as a reclassification adjustment in other comprehensive income. Gains and losses on sales of securities are determined on the specific-identification method.

**COMMUNITY FIRST BANCORPORATION, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2011 AND 2010**

**Note 2      Summary of Significant Accounting Policies, continued**

Investment Securities, continued

Declines in the fair value of individual held-to-maturity and available-for-sale securities below their amortized cost that are other than temporary result in writedowns of the individual securities to their fair value. The related writedowns are included in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer and (3) the intent and ability of the Corporation to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

Federal Home Loan Bank Stock

At December 31, 2011 and 2010, the Corporation had \$229,000 recorded for stock in the Federal Home Loan Bank (FHLB). As a member of the FHLB system, the Corporation is required to maintain an investment in capital stock of the FHLB in an amount equal to the greater of 1% of its outstanding home loans or 5% of advances from the FHLB. The recorded amount of FHLB stock equals its fair value because the shares can only be redeemed by the FHLB at the \$100 per share par value. This stock is classified as a restricted investment security, carried at cost and evaluated annually for impairment. During 2011 and 2010, no impairment loss was recorded.

Loans Held-for-Sale

Mortgage loans originated for sale in the foreseeable future in the secondary market are carried at the lower of aggregate cost or estimated market value. Gains and losses on sales of loans are recognized at the settlement date and are determined by the difference between the sales proceeds and the carrying value of the loans. Sales are made without recourse. Net unrealized losses, if any, are recognized through a valuation allowance established by charges to income.

Loans

Loans are stated at the principal amount outstanding less the allowance for loan losses. Interest income on loans is recognized based upon the principal amounts outstanding. Generally the accrual of interest on loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due or when they are past due 90 days as to either principal or interest, unless they are well secured and in the process of collection. When interest accrual is discontinued, all unpaid accrued interest is reversed against current income. If management determines that the ultimate collectibility of principal is in doubt, cash receipts on nonaccrual loans are applied to reduce the principal balance on a cash-basis method, until the loans qualify for return to accrual status or principal is paid in full. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured. Past due status is determined based on contractual terms.

Loan origination fees are recognized as income and loan origination costs are expensed as incurred, as management has determined that capitalization of these items would be immaterial to the consolidated financial statements.

**COMMUNITY FIRST BANCORPORATION, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2011 AND 2010**

**Note 2      Summary of Significant Accounting Policies, continued**

Allowance for Loan Losses

The allowance for loan losses is comprised of amounts charged against income in the form of the provision for loan losses, less charged-off loans, net of recoveries. Loans are charged against the allowance for loan losses when management believes that collection of the principal is unlikely. Subsequent recoveries, if any, are credited to the allowance for loan losses.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as doubtful, substandard or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A loan is considered impaired when, based on current information and events, it is probable that the Corporation will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price or the fair value of the collateral if the loan is collateral dependent. Large groups of smaller balance homogenous loans are collectively evaluated for impairment; accordingly, the Corporation does not separately identify individual consumer and residential loans for impairment disclosures, unless such loans are subject to a restructuring agreement.

Periodically, regulatory agencies review the Corporation's allowance for loan losses as an integral part of their examination process, and may require the Corporation to make additions to the allowance based on their judgment about information available to them at the time of their examination.

**COMMUNITY FIRST BANCORPORATION, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2011 AND 2010**

**Note 2      Summary of Significant Accounting Policies, continued**

Bank Premises and Equipment

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation expense is computed using the straight-line method based upon the estimated useful lives of the assets, which range from 3 to 7 years for furniture and equipment, and 30 to 40 years for buildings and improvements. Leasehold improvements are amortized over the term of the lease or the estimated useful life of the improvement, whichever is less.

Maintenance and repairs are charged to operating expenses. Renewals and betterments are added to the asset accounts and depreciated over the periods benefited. Depreciable assets sold or retired are removed from the asset and related accumulated depreciation accounts and any gain or loss is reflected in the income and expense accounts. These assets are reviewed for impairment when events indicate their carrying value may not be recoverable. If management determines that an impairment exists, the asset is reduced with an offsetting charge to expense.

Other Real Estate

Other real estate is foreclosed property held pending disposition and is initially recorded at fair value less estimated selling costs when acquired, establishing a new cost basis. At foreclosure, if the fair value of the real estate acquired less estimated selling costs is less than the Corporation's recorded investment in the related loan, a writedown is recognized through a charge to the allowance for loan losses. Costs of significant property improvements are capitalized, whereas costs relating to holding property are expensed. Valuations are periodically performed by management, and any subsequent writedowns are recorded as a charge to income, if necessary, to reduce the carrying value of the property to its fair value less estimated selling costs. Sales of other real estate are accounted for according to authoritative guidance issued by the FASB.

Goodwill

Goodwill resulted from the Connell branch acquisition and represents the excess of the purchase price over the fair value of acquired tangible assets and liabilities and identifiable intangible assets. Goodwill is assessed at least annually for impairment and any such impairment is recognized in the period identified. During 2011 and 2010, no impairment loss was recognized.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when: (1) the assets have been isolated from the Corporation, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets and (3) the Corporation does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

**COMMUNITY FIRST BANCORPORATION, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2011 AND 2010**

**Note 2      Summary of Significant Accounting Policies, continued**

Reserve for Unfunded Commitments

During 2011, the Corporation established a reserve for possible losses associated with commitments to lend funds under existing agreements. Management determines the adequacy of the reserve for unfunded commitments by evaluating the outstanding commitment levels, the expected conversion to loans, historical loss estimates and other relevant factors. This evaluation is inherently subjective and actual losses may vary from current estimates. Changes in the reserve are reported in earnings in the periods they become known. The reserve for unfunded commitments is included in accrued expenses and other liabilities in the accompanying consolidated balance sheets. At December 31, 2011, this reserve totaled \$50,000.

Federal Income Taxes

Effective January 1, 2006, the shareholders of the Corporation elected to be taxed as a Subchapter "S" Corporation under Internal Revenue Service Code Section 1362. In lieu of corporate income taxes, the shareholders of a Subchapter S Corporation are taxed on their proportionate share of the Corporation's taxable income.

The Corporation and the Bank join in filing federal income tax returns.

The Companies maintain their records for financial reporting on the accrual basis of accounting. The Companies maintain their records for income tax reporting on the cash basis of accounting.

In accordance with authoritative guidance issued by the FASB, the Corporation performed an evaluation to determine if there were any uncertain tax positions that would have an impact on the consolidated financial statements. No uncertain tax positions were identified. The December 31, 2008 through December 31, 2011 tax years remain subject to examination by the Internal Revenue Service. The Corporation does not believe that any reasonably possible changes will occur within the next 12 months which will have a material impact on the consolidated financial statements. The Corporation records incurred penalties and interest in other non-interest expense. There were no penalties and interest assessed by taxing authorities during 2011 or 2010.

Stock-Based Compensation

The Corporation has stock-based employee compensation plans which are more fully described in Note 16. The Corporation has adopted authoritative guidance issued by the FASB regarding accounting for stock compensation expense. As a result of adopting the FASB authoritative guidance, the Corporation's net income is \$32,000 and \$25,000 lower for the years ended December 31, 2011 and 2010, respectively.

Comprehensive Income

The Corporation has adopted authoritative guidance issued by the FASB. The FASB authoritative guidance establishes standards for reporting and display of comprehensive income and its components. The Corporation reports comprehensive income in the statement of changes in shareholders' equity.

**COMMUNITY FIRST BANCORPORATION, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2011 AND 2010**

**Note 2      Summary of Significant Accounting Policies, continued**

Advertising Costs

Advertising costs are expensed as incurred. Advertising costs in the amount of \$38,000 and \$40,000 were expensed during 2011 and 2010, respectively.

Fair Values of Financial Instruments

Authoritative guidance issued by the FASB requires disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instruments. The FASB authoritative guidance excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Corporation.

The following methods and assumptions were used by the Corporation in estimating its fair value disclosures for financial instruments:

***Cash and Cash Equivalents:*** The carrying amounts reported in the balance sheet for cash and cash equivalents approximate those assets' fair values.

***Interest-Bearing Deposits:*** Fair values for interest-bearing deposits are estimated using a discounted cash flow analysis that applies interest rates currently being offered on similar deposits to a schedule of aggregated contractual maturities on such deposits.

***Investment Securities:*** Fair values for investment securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments.

***Federal Home Loan Bank Stock:*** The carrying amount reported in the balance sheet for FHLB stock approximates its fair value.

***Loans Held-for-Sale:*** Fair values for loans held-for-sale are based on their estimated market price.

***Loans:*** For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying amounts. The fair values for other loans (for example, fixed rate commercial real estate and rental property mortgage loans and commercial and industrial loans) are estimated using discounted cash flow analysis, based on interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Loan fair value estimates include judgments regarding future expected loss experience and risk characteristics. Fair values for impaired loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable. The carrying amount of accrued interest receivable approximates its fair value.

***Bank-Owned Life Insurance:*** The carrying amount reported in the balance sheet for bank-owned life insurance approximates its fair value.

**COMMUNITY FIRST BANCORPORATION, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2011 AND 2010**

**Note 2      Summary of Significant Accounting Policies, continued**

Fair Values of Financial Instruments, continued

**Deposits:** The fair values disclosed for demand deposits (for example, interest-bearing checking accounts and savings accounts) are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The fair values for time deposits are estimated using a discounted cash flow calculation that applies interest rates currently being offered on time deposits to a schedule of aggregated contractual maturities on such time deposits. The carrying amount of accrued interest payable approximates its fair value.

**Short-Term Borrowings:** The carrying amounts of short-term borrowings approximate their fair values.

**FHLB Advances and Other Long-Term Borrowings:** The fair values of FHLB advances and other long-term borrowings are estimated using discounted cash flow analyses based on the current incremental borrowing rates for similar types of borrowing arrangements.

Book Value and Tangible Book Value per Share

Book value per share is calculated by dividing the total shareholders' equity shown on the consolidated balance sheets by the number of shares outstanding as of year-end. At December 31, 2011 and 2010, the book value per share is \$38.75 and \$34.59, respectively. Tangible book value per share is calculated by dividing the net amount of total shareholders' equity less goodwill shown on the consolidated balance sheets by the number of shares outstanding as of year-end. At December 31, 2011 and 2010, the tangible book value per share is \$37.64 and \$33.48, respectively.

Subsequent Events

Subsequent events are events or transactions that occur after the balance sheet date but before the consolidated financial statements are available to be issued. The Corporation recognizes in the consolidated financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing the consolidated financial statements. The Corporation's consolidated financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after the balance sheet date and before the consolidated financial statements are available to be issued. The Corporation has evaluated subsequent events from December 31, 2011 through March 6, 2012, the date the financial statements were available to be issued. The Corporation did not note any subsequent events requiring disclosure or adjustment to these consolidated financial statements.



**COMMUNITY FIRST BANCORPORATION, INC. AND SUBSIDIARY**  
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**Note 2      Summary of Significant Accounting Policies, continued**

New Accounting Standards

Accounting Standards Update (ASU) No. 2010-06, *Fair Value Measurements and Disclosures (Topic 820) – Improving Disclosures About Fair Value Measurements*, requires expanded disclosures related to fair value measurements including (i) the amounts of significant transfers of assets or liabilities between Levels 1 and 2 of the fair value hierarchy and the reasons for the transfers, (ii) the reasons for transfer of assets or liabilities in or out of Level 3 of the fair value hierarchy, with significant transfers disclosed separately, (iii) the policy for determining when transfers between levels of the fair value hierarchy are recognized and (iv) for recurring fair value measurements of assets and liabilities in Level 3 of the fair value hierarchy, a gross presentation of information about purchases, sales, issuances and settlements. ASU 2010-06 further clarifies that (i) fair value measurement disclosures should be provided for each class of assets and liabilities (rather than major category), which would generally be a subset of assets or liabilities within a line item in the statement of financial position and (ii) companies should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements for each class of assets and liabilities included in Levels 2 and 3 of the fair value hierarchy. The disclosures related to the gross presentation of purchases, sales, issuances and settlements of assets and liabilities included in Level 3 of the fair value hierarchy became effective for the Corporation on January 1, 2011. The remaining disclosure requirements and clarifications made by ASU 2010-06 became effective for the Corporation on January 1, 2010. See Note 20 - Fair Value Measurements.

ASU No. 2010-20, *Receivables (Topic 310) – Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*, requires entities to provide disclosures designed to facilitate financial statement users' evaluation of (i) the nature of credit risk inherent in the entity's portfolio of financing receivables, (ii) how that risk is analyzed and assessed in arriving at the allowance for loan losses and (iii) the changes and reasons for those changes in the allowance for loan losses. Disclosures must be disaggregated by portfolio segment, the level at which an entity develops and documents a systematic method for determining its allowance for loan losses, and class of financing receivable, which is generally a disaggregation of portfolio segment. The required disclosures include, among other things, a rollforward of the allowance for loan losses as well as information about modified, impaired, nonaccrual and past due loans and credit quality indicators. ASU 2010-20 was effective for the Corporation's financial statements as of December 31, 2011, as it relates to disclosures required as of the end of a reporting period. Disclosures that relate to activity during a reporting period became effective for the Corporation's financial statements on January 1, 2011. Certain disclosures related to troubled debt restructurings were temporarily deferred by ASU 2011-01, *Receivables (Topic 310) – Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20*, and will be effective January 1, 2012 as required by ASU No. 2011-02, *Receivables (Topic 310) – A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring*, as further discussed below. See Note 5 - Loans and Allowance for Loan Losses.

**COMMUNITY FIRST BANCORPORATION, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2011 AND 2010**

**Note 2      Summary of Significant Accounting Policies, continued**

New Accounting Standards, continued

ASU No. 2010-28, *Intangibles – Goodwill and Other (Topic 350) – When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts*, modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist such as if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. ASU 2010-28 is effective for periods beginning on or after December 15, 2011 and is not expected to have a significant impact on the Corporation's financial statements.

ASU No. 2011-02, *Receivables (Topic 310) – A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring*, clarifies when loan modifications constitute troubled debt restructurings and is intended to assist creditors in determining whether a modification of the terms of a receivable meets the criteria to be considered a troubled debt restructuring, both for purposes of recording an impairment loss and for disclosure of troubled debt restructurings. In evaluating whether a restructuring constitutes a troubled debt restructuring, a creditor must separately conclude, under the guidance clarified by ASU 2011-02, that both of the following exist: (a) the restructuring constitutes a concession and (b) the debtor is experiencing financial difficulties. ASU 2011-02 is effective for annual periods ending on or after December 15, 2012 and will be applied retrospectively to restructurings occurring on or after January 1, 2012 and is not expected to have a significant impact on the Corporation's financial statements.

ASU 2011-04, *Fair Value Measurement (Topic 820) – Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRS*, amends Topic 820, *Fair Value Measurements and Disclosures*, to converge the fair value measurement guidance in U.S. generally accepted accounting principles and International Financial Reporting Standards. ASU 2011-04 clarifies the application of existing fair value measurement requirements, changes certain principles in Topic 820 and requires additional fair value disclosures. ASU 2011-04 is effective for annual periods beginning after December 15, 2011 and is not expected to have a significant impact on the Corporation's financial statements.

ASU 2011-05, *Comprehensive Income (Topic 220) – Presentation of Comprehensive Income*, amends Topic 220, *Comprehensive Income*, to require that all non-owner changes in shareholders' equity be presented in either a single continuous statement of comprehensive income or in two separate but consecutive statements. Additionally, ASU 2011-05 requires entities to present, on the face of the financial statements, reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement or statements where the components of net income and the components of other comprehensive income are presented. The option to present components of other comprehensive income as part of the statement of changes in shareholders' equity was eliminated. ASU 2011-05 is effective for annual periods ending after December 15, 2012; however, certain provisions related to the presentation of reclassification adjustments have been deferred by ASU 2011-12, *Comprehensive Income (Topic 220) – Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*, as further discussed below. ASU 2011-05 is not expected to have a significant impact on the Corporation's financial statements.

**COMMUNITY FIRST BANCORPORATION, INC. AND SUBSIDIARY**  
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**Note 2      Summary of Significant Accounting Policies, continued**

New Accounting Standards, continued

ASU 2011-08, *Intangibles – Goodwill and Other (Topic 350) – Testing Goodwill for Impairment*, amends Topic 350, *Intangibles – Goodwill and Other*, to give entities the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. However, if an entity concludes otherwise, then it is required to perform the first step of the two-step impairment test by calculating the fair value of the reporting unit and comparing the fair value with the carrying amount of the reporting unit. ASU 2011-08 is effective for annual and interim impairment tests beginning after December 15, 2011, and is not expected to have a significant impact on the Corporation's financial statements.

**Note 3      Restrictions on Cash and Due From Banks**

The Corporation is required to maintain reserve funds in cash or on deposit with the Federal Reserve Bank. The required reserve at December 31, 2011 and 2010 was \$4,387,000 and \$2,250,000, respectively.

**COMMUNITY FIRST BANCORPORATION, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**Note 4 Investment Securities**

The amortized cost and fair values of investment securities at December 31, 2011 are as follows (in thousands):

	<b>December 31, 2011</b>			
	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>
<b>Available-for-sale:</b>				
U.S. Government agencies	\$ 8,367	\$ 113	\$ -	\$ 8,480
U.S. Government agency mortgage-backed securities	2,064	38	(3)	2,099
Collateralized mortgage obligations	4,038	42	(43)	4,037
Obligations of state and political subdivisions	4,480	70	-	4,550
Corporate bonds	1,507	7	-	1,514
Total available-for-sale securities	<u>\$ 20,456</u>	<u>\$ 270</u>	<u>\$ (46)</u>	<u>\$ 20,680</u>

The balance sheet as of December 31, 2011 reflects the fair value of available-for-sale securities in the amount of \$20,680,000. A net unrealized gain of \$224,000 is in the available-for-sale investment securities balance. The unrealized gain is included in shareholders' equity.

The amortized cost and fair values of investment securities at December 31, 2010 are as follows (in thousands):

	<b>December 31, 2010</b>			
	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>
<b>Available-for-sale:</b>				
U.S. Government agencies	\$ 20,170	\$ 27	\$ (54)	\$ 20,143
U.S. Government agency mortgage-backed securities	1,827	38	(4)	1,861
Collateralized mortgage obligations	539	-	(5)	534
Obligations of state and political subdivisions	1,302	-	-	1,302
Corporate bonds	1,506	16	-	1,522
Total available-for-sale securities	<u>\$ 25,344</u>	<u>\$ 81</u>	<u>\$ (63)</u>	<u>\$ 25,362</u>

The balance sheet as of December 31, 2010 reflects the fair value of available-for-sale securities in the amount of \$25,362,000. A net unrealized gain of \$18,000 is in the available-for-sale investment securities balance. The unrealized gain is included in shareholders' equity.

**COMMUNITY FIRST BANCORPORATION, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2011 AND 2010**

**Note 4 Investment Securities, continued**

The amortized cost and fair value of debt securities at December 31, 2011, by contractual maturity, are shown below (in thousands). Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Mortgage-backed securities and collateralized mortgage obligations are shown separately, since they are not due at a single maturity date.

	<b>Available-for-Sale</b>	
	<b>Amortized Cost</b>	<b>Fair Value</b>
Amounts maturing in:		
One year or less	\$ 1,507	\$ 1,514
After one year through five years	6,355	6,463
After five years through ten years	4,651	4,717
After ten years	1,841	1,850
	14,354	14,544
 U.S. Government agency		
mortgage-backed securities	2,064	2,099
Collateralized mortgage obligations	4,038	4,037
Totals	\$ 20,456	\$ 20,680

Investment securities with fair market values of \$3,371,000 and \$2,857,000 at December 31, 2011 and 2010, respectively, were pledged to secure public deposits and for other purposes as required or permitted by law. Included in these pledged investment securities are securities with fair values of \$1,235,000 and \$1,273,000 at December 31, 2011 and 2010, respectively, to secure short-term borrowings. See Note 8 for additional information.

The Corporation received proceeds totaling \$2,250,000 from the sales of investment securities during 2011. These sales resulted in gross realized gains of \$82,000. No investment securities were sold in 2010.

**COMMUNITY FIRST BANCORPORATION, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**Note 4 Investment Securities, continued**

Information pertaining to securities with gross unrealized losses at December 31, 2011 and 2010, aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows (in thousands):

	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
December 31, 2011:						
Federal agencies	\$ 2,538	\$ (46)	\$ -	\$ -	\$ 2,538	\$ (46)
Total	\$ 2,538	\$ (46)	\$ -	\$ -	\$ 2,538	\$ (46)
December 31, 2010:						
Federal agencies	\$ 9,588	\$ (63)	\$ -	\$ -	\$ 9,588	\$ (63)
Total	\$ 9,588	\$ (63)	\$ -	\$ -	\$ 9,588	\$ (63)

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer and (3) the intent and ability of the Corporation to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

At December 31, 2011, the four debt securities with unrealized losses have depreciated 1.77% from the Corporation's amortized cost basis. These securities are guaranteed by either the U.S. Government or other governments. The unrealized losses relate principally to current interest rates for similar types of securities. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred and the results of reviews of the issuer's financial condition. As management has the ability to hold debt securities until maturity, or for the foreseeable future if classified as available-for-sale, no declines are deemed to be other-than-temporary.

**COMMUNITY FIRST BANCORPORATION, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2011 AND 2010**

**Note 5      Loans and Allowance for Loan Losses**

An analysis of loan categories at December 31, 2011 and 2010 is as follows (in thousands):

	<u>2011</u>	<u>2010</u>
Commercial, agricultural and industrial loans	\$ 21,268	\$ 27,611
Real estate (RE) loans:		
Construction, land and land development	14,217	12,621
Residential 1-4 family	14,878	11,585
Commercial RE	65,309	59,738
Dealer contracts	47	170
Consumer loans	2,816	2,546
Overdrafts	<u>111</u>	<u>3</u>
	118,646	114,274
Less: Allowance for loan losses	<u>1,713</u>	<u>1,583</u>
Loans, Net	<u>\$ 116,933</u>	<u>\$ 112,691</u>

Residential 1-4 family loans shown above include mortgage loans held-for-sale totaling \$261,000 and \$417,000 at December 31, 2011 and 2010, respectively.

**COMMUNITY FIRST BANCORPORATION, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2011 AND 2010**

**Note 5    Loans and Allowance for Loan Losses, continued**

Transactions in the allowance for loan losses are summarized as follows (in thousands):

	<b>Commercial, Agricultural and Industrial</b>	<b>Construction, Land and Land Development</b>	<b>Residential 1-4 Family</b>	<b>Commercial RE</b>	<b>Consumer and Other</b>	<b>Unallocated</b>	<b>2011 Total</b>	<b>2010 Total</b>
<b><u>Allowance for Loan Losses:</u></b>								
Balance, beginning of year	\$ 357	\$ 193	\$ 97	\$ 886	\$ 24	\$ 26	\$ 1,583	\$ 1,328
Provisions, charged (credited) to income	<u>(104)</u>	<u>(91)</u>	<u>(6)</u>	<u>(343)</u>	<u>12</u>	<u>630</u>	<u>98</u>	<u>301</u>
	253	102	91	543	36	656	1,681	1,629
Loans charged-off	-	-	-	-	(9)	-	(9)	(137)
Recoveries of loans previously charged-off	<u>7</u>	<u>-</u>	<u>31</u>	<u>-</u>	<u>3</u>	<u>-</u>	<u>41</u>	<u>91</u>
Net (charge-offs) recoveries	<u>7</u>	<u>-</u>	<u>31</u>	<u>-</u>	<u>(6)</u>	<u>-</u>	<u>32</u>	<u>(46)</u>
Balance, end of year	<u>\$ 260</u>	<u>\$ 102</u>	<u>\$ 122</u>	<u>\$ 543</u>	<u>\$ 30</u>	<u>\$ 656</u>	<u>\$ 1,713</u>	<u>\$ 1,583</u>
Ending balance: Individually evaluated for impairment	\$ -	\$ -	\$ 17	\$ 42	\$ 1	\$ -	\$ 60	\$ 106
Ending balance: Collectively evaluated for impairment	<u>260</u>	<u>102</u>	<u>105</u>	<u>501</u>	<u>29</u>	<u>656</u>	<u>1,653</u>	<u>1,477</u>
Balance, end of year	<u>\$ 260</u>	<u>\$ 102</u>	<u>\$ 122</u>	<u>\$ 543</u>	<u>\$ 30</u>	<u>\$ 656</u>	<u>\$ 1,713</u>	<u>\$ 1,583</u>
<b><u>Loans:</u></b>								
Ending balance: Individually evaluated for impairment	\$ 5	\$ -	\$ 460	\$ 1,570	\$ 15		\$ 2,050	\$ 1,456
Ending balance: Collectively evaluated for impairment	<u>21,263</u>	<u>14,217</u>	<u>14,418</u>	<u>63,739</u>	<u>2,959</u>		<u>116,596</u>	<u>112,818</u>
Ending balance total loans	<u>\$ 21,268</u>	<u>\$ 14,217</u>	<u>\$ 14,878</u>	<u>\$ 65,309</u>	<u>\$ 2,974</u>		<u>\$ 118,646</u>	<u>\$ 114,274</u>



**COMMUNITY FIRST BANCORPORATION, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**Note 5    Loans and Allowance for Loan Losses, continued**

Federal regulations require that the Corporation periodically evaluate the risks inherent in its loan portfolio. In addition, the Corporation's regulatory agencies have authority to identify problem loans and, if appropriate, require them to be reclassified. There are three classifications for problem loans: Substandard, Doubtful and Loss. Substandard loans have one or more defined weaknesses and are characterized by the distinct possibility that the Corporation will sustain some loss if the deficiencies are not corrected. Doubtful loans have the weaknesses of loans classified as "Substandard," with additional characteristics that suggest the weaknesses make collection or recovery in full after liquidation of collateral questionable on the basis of currently existing facts, conditions and values. There is a high possibility of loss in loans classified as "Doubtful." A loan classified as "Loss" is considered uncollectible and of such little value that continued classification of the credit as a loan is not warranted. If a loan or a portion thereof is classified as "Loss," it must be charged-off, meaning the amount of the loss is charged against the allowance for loan losses, thereby reducing that reserve. The Corporation also classifies some loans as "Watch" or "Other Assets Especially Mentioned" ("OAEM"). Loans classified as Watch are performing assets and classified as pass credits but have elements of risk that require more monitoring than other performing loans. Loans classified as OAEM are assets that continue to perform but have shown deterioration in credit quality and require close monitoring.

Loans by credit quality risk rating at December 31, 2011 are as follows (in thousands):

	<u>Pass</u>	<u>Other Assets Especially Mentioned</u>	<u>Sub- Standard</u>	<u>Doubtful</u>	<u>Total</u>
Commercial, agricultural and industrial loans	\$ 19,995	\$ 1,017	\$ 256	\$ -	\$ 21,268
Real estate (RE) loans:					
Construction, land and land development	13,552	369	296	-	14,217
Residential 1-4 family	14,083	37	758	-	14,878
Commercial RE	60,283	1,041	3,985	-	65,309
Consumer and other loans	2,882	58	34	-	2,974
Total Loans	<u>\$ 110,795</u>	<u>\$ 2,522</u>	<u>\$ 5,329</u>	<u>\$ -</u>	<u>\$ 118,646</u>

**COMMUNITY FIRST BANCORPORATION, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**Note 5    Loans and Allowance for Loan Losses, continued**

An analysis of nonaccrual loans by category at December 31, 2011 and 2010 is as follows (in thousands):

	<u>2011</u>	<u>2010</u>
Commercial, agriculture and industrial loans	\$ -	\$ 397
Real estate (RE) loans:		
Construction, land and land development	33	-
Residential 1-4 family	1	10
Commercial RE	431	355
Consumer and other loans	<u>14</u>	<u>19</u>
Total nonaccrual loans	<u>\$ 479</u>	<u>\$ 781</u>

At December 31, 2011 and 2010, a summary of information pertaining to impaired loans is as follows (in thousands):

	<u>Unpaid Contractual Principal Balance</u>	<u>Recorded Investment with No Allowance</u>	<u>Recorded Investment with Allowance</u>	<u>Total Recorded Investment</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
<b>December 31, 2011:</b>							
Commercial, agriculture and industrial loans	\$ 5	\$ -	\$ 5	\$ 5	\$ -	\$ 227	\$ 1
Real estate (RE) loans:							
Residential 1-4 family	462	-	460	460	17	521	23
Commercial RE	1,609	-	1,570	1,570	42	988	71
Consumer and other loans	<u>17</u>	<u>-</u>	<u>15</u>	<u>15</u>	<u>1</u>	<u>17</u>	<u>-</u>
Total	<u>\$ 2,093</u>	<u>\$ -</u>	<u>\$ 2,050</u>	<u>\$ 2,050</u>	<u>\$ 60</u>	<u>\$ 1,753</u>	<u>\$ 95</u>
<b>December 31, 2010:</b>							
Commercial, agriculture and industrial loans	\$ 495	\$ -	\$ 449	\$ 449	\$ 28	\$ 362	\$ -
Real estate (RE) loans:							
Residential 1-4 family	583	-	582	582	45	298	-
Commercial RE	405	-	405	405	31	202	-
Consumer and other loans	<u>20</u>	<u>-</u>	<u>20</u>	<u>20</u>	<u>2</u>	<u>11</u>	<u>-</u>
Total	<u>\$ 1,503</u>	<u>\$ -</u>	<u>\$ 1,456</u>	<u>\$ 1,456</u>	<u>\$ 106</u>	<u>\$ 873</u>	<u>\$ -</u>

The Corporation has no commitments to loan additional funds to borrowers whose loans are impaired.

**COMMUNITY FIRST BANCORPORATION, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**Note 5    Loans and Allowance for Loan Losses, continued**

Troubled Debt Restructurings

The restructuring of a loan is considered a “troubled debt restructuring” if both (i) the borrower is experiencing financial difficulties and (ii) the creditor has granted a concession. Concessions may include interest rate reductions or below market interest rates, principal forgiveness, restructuring amortization schedules and other actions intended to minimize potential losses. Troubled debt restructurings during 2011 are set forth in the following table (in thousands):

	<b>Number of Contracts</b>	<b>Balance at Restructuring Date</b>	<b>Balance at December 31, 2011</b>
Real estate (RE) loans:			
Construction, land and land development	1	\$     450	\$     450
Residential 1-4 family	2	463	459
<b>Total troubled debt restructurings</b>	<b>3</b>	<b>\$     913</b>	<b>\$     909</b>

Concessions granted on these loans include reduction of interest rates and restructuring payments to match borrower’s cash flow. At December 31, 2011, all of these loans were paying in accordance to the restructured terms.

The following table illustrates an age analysis of past due loans as of December 31, 2011 (in thousands):

	<b>30-89 Days Past Due</b>	<b>90 Days or More Past Due</b>	<b>Total Past Due</b>	<b>Current</b>	<b>Total Loans</b>	<b>Recorded Investment 90 Days or More and Still Accruing</b>
Commercial, agricultural and industrial loans	\$    52	\$     -	\$    52	\$ 21,216	\$ 21,268	\$     -
Real estate (RE) loans:						
Construction, land and land development	65	33	98	14,119	14,217	-
Residential 1-4 family	505	-	505	14,373	14,878	-
Commercial RE	657	-	657	64,652	65,309	-
Consumer and other loans	32	14	46	2,928	2,974	-
<b>Total</b>	<b>\$ 1,311</b>	<b>\$    47</b>	<b>\$ 1,358</b>	<b>\$ 117,288</b>	<b>\$ 118,646</b>	<b>\$     -</b>

At December 31, 2010, there were no loans past due ninety days or more and still accruing interest

Dealer contracts represent automobile purchase contracts which the Corporation buys from automobile dealers in its primary market area. Such contracts represent less than 1% of the Corporation’s loan portfolio at December 31, 2011 and 2010.

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**Note 5      Loans and Allowance for Loan Losses, continued**

The Corporation grants commercial, consumer and real estate loans to customers within Southeastern Washington State. A substantial portion of its debtors' ability to honor their contracts is dependent upon the commercial and real estate economic sectors in that geographic area.

**Note 6      Bank Premises and Equipment**

The investment in bank premises and equipment at December 31, 2011 and 2010 is as follows (in thousands):

	<b>2011</b>	<b>2010</b>
Land	\$     452	\$     452
Buildings	2,529	2,529
Leasehold improvements	249	249
Furniture and equipment	1,119	1,055
Premises and equipment in process	48	-
	4,397	4,285
 Less accumulated depreciation and amortization	 1,495	 1,294
Bank premises and equipment, net	 \$     2,902	 \$     2,991

Depreciation and amortization on bank premises and equipment charged to expense totaled \$202,000 and \$215,000 for the years ended December 31, 2011 and 2010, respectively. Computer software, net of accumulated amortization, is included in Other Assets. Amortization on computer software charged to expense totaled \$34,000 and \$49,000 for the years ended December 31, 2011 and 2010, respectively.

The Corporation owns the building that houses its main branch and leases the land and a sign from a director. The lease is classified as an operating lease with an initial term of ten years and minimum annual rents of \$28,000, with cost of living increases annually. The initial lease term expires February 28, 2012 and includes four renewal options of five years each. The Corporation has also entered into a lease agreement for the Richland branch facilities, which opened in January 2006. The original lease was for a term of five years with renewal option of another five years and provided for minimum annual rents of \$61,000. On December 31, 2010, the renewal option was exercised and will expire December 31, 2015.

The Corporation recorded lease expense in the amount of \$148,000 and \$153,000 for the years ended December 31, 2011 and 2010, respectively. Included in the lease expense were amounts paid to a related party in the amount of \$51,000 and \$50,000 for the years ended December 31, 2011 and 2010, respectively.

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**Note 6 Bank Premises and Equipment, continued**

The minimum payments under the land and branch leases required for the next five years are as follows (in thousands):

2012	\$ 95
2013	95
2014	94
2015	94
2016	-
Total	<u>\$ 378</u>

The land lease contains renewal clauses from five to twenty years and escalation clauses based on increases in the Consumer Price Index. The main branch lease provides for increases beginning with the fourth year which are specified within the lease agreement.

**Note 7 Deposits**

The carrying amounts of deposits at December 31, 2011 and 2010 are as follows (in thousands):

	<u>2011</u>	<u>2010</u>
Demand	\$ 66,046	\$ 47,678
Interest-bearing transaction accounts	88,022	80,818
Savings	5,279	4,610
Time deposits less than \$100,000	6,469	7,150
Time deposits \$100,000 and over	13,812	11,105
Total deposits	<u>\$ 179,628</u>	<u>\$ 151,361</u>

Maturities of time deposits for each of the next five years and thereafter are as follows (in thousands):

2012	\$ 14,753
2013	2,542
2014	1,345
2015	345
2016	784
Thereafter	512
	<u>\$ 20,281</u>

Included in deposits at December 31, 2011 and 2010 are brokered deposits, obtained from customers outside the Corporation's primary market area, totaling \$189,000 and \$501,000, respectively.

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**Note 8 Short-Term Borrowings**

At December 31, 2011, there were no demand notes issued to the U.S. Treasury. At December 31, 2010, the Corporation has demand notes issued to the U.S. Treasury totaling \$450,000. No interest was charged on the outstanding balance as of December 31, 2010. The demand notes are collateralized by investment securities. See Note 4 for additional information.

**Note 9 Long-Term Borrowings**

During 2008, the Corporation borrowed \$500,000 from the Federal Home Loan Bank. Interest is assessed at a fixed rate of 4.97%. Interest payments are due monthly with principal and any unpaid interest due at the maturity date on May 9, 2018. This borrowing is collateralized by investment securities with a carrying amount of \$180,000 at December 31, 2011 and a blanket pledge of eligible loans with a carrying amount of \$9,258,000 at December 31, 2011. See Note 4 for additional information. Refer to Note 14 for additional information regarding the amount available under this borrowing line.

On March 27, 2009, the Corporation borrowed \$3,000,000 from another financial institution. Interest is equal to the Prime rate index or a floor interest rate of 4.50% whichever is greater. On November 15, 2011, the Corporation borrowed \$2,164,000 from another financial institution. These loan proceeds were used to pay-off the loan obtain during 2009. Interest on this loan is equal to the Prime rate index. At December 31, 2011, the interest rate was 3.25%. Quarterly principal and interest payments in the amount of \$189,000 are due for eleven consecutive quarters beginning December 31, 2011 with remaining unpaid principal and interest due at maturity on September 30, 2014. This note is secured by 100% of the outstanding stock of Community First Bank.

Principal payments due on long-term borrowings at December 31, 2011 for the next five years and thereafter are as follows (in thousands):

2012	\$	882
2013		724
2014		558
2015		-
2016		-
Thereafter		500
	\$	<u>2,664</u>

**Note 10 Related Party Transactions**

During 2011 and 2010, the Corporation had transactions made in the ordinary course of business with certain of its officers, directors and principal shareholders. All loans included in such transactions were made on substantially the same terms, including interest rate and collateral, as those prevailing at the time for comparable transactions with other persons, and did not, in the opinion of management, involve more than normal credit risk or present other unfavorable features.

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**Note 10 Related Party Transactions, continued**

A summary of these transactions follows (in thousands):

	<u>Balance Beginning of Year</u>	<u>Additions</u>	<u>Amounts Collected</u>	<u>Balance End of Year</u>
For the year ended:				
December 31, 2011	\$ 49	\$ 118	\$ (167)	\$ -
December 31, 2010	\$ 50	\$ 261	\$ (262)	\$ 49

The Corporation held deposits for certain of its officers, directors and principal shareholders in the amount of \$23,998,000 and \$22,772,000 at December 31, 2011 and 2010, respectively.

The Corporation has entered into a lease agreement with a related party for the land and sign at its main branch. Refer to Note 6 for additional information regarding this lease agreement.

**Note 11 Financial Instruments with Off-Balance-Sheet Risk**

In the normal course of business, there are outstanding various commitments and contingent liabilities, such as commitments to extend credit and standby letters of credit, which are not reflected in the financial statements. The Corporation's exposure to credit loss in the event of nonperformance by the other party to the financial instruments for commitments to extend credit and standby letters of credit is represented by the contractual or notional amount of those instruments. The Corporation uses the same credit policies in making such commitments as it does for instruments that are included in the balance sheets.

Financial instruments whose contract amount represents credit risk were as follows (in thousands):

	<u>2011</u>	<u>2010</u>
Commitments to extend credit	\$ 35,375	\$ 31,422
Standby letters of credit	-	-

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 many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Corporation's experience has been that approximately 70% of loan commitments are drawn upon by customers. The Corporation evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Corporation upon extension of credit, is based on management's credit evaluation. Collateral held varies but may include accounts receivable, inventory, property and equipment and income-producing commercial properties.

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**Note 11    Financial Instruments with Off-Balance-Sheet Risk, continued**

Standby letters of credit are conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. Standby letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Corporation's policy for obtaining collateral, and the nature of such collateral, is essentially the same as that involved in making commitments to extend credit.

The Corporation has guaranteed credit cards issued by another financial institution to some of the Corporation's customers. The Corporation has exposure to credit loss in the event that there is nonperformance by their customer.

The Corporation has not been required to perform on any financial guarantees during 2011 or 2010. The Corporation has not incurred any material losses on its commitments in 2011 or 2010.

**Note 12    Compensated Absences**

Employees of the Corporation are entitled to paid vacation, paid sick days and personal days off, depending on job classification, length of service and other factors. It is impracticable to estimate the amount of compensation for future absences, and accordingly, no liability has been recorded in the accompanying financial statements. The Corporation's policy is to recognize the costs of compensated absences when actually paid to employees.

**Note 13    Commitments and Contingent Liabilities**

The Corporation is subject to claims and lawsuits which arise primarily in the ordinary course of business. It is the opinion of management that the disposition or ultimate resolution of such claims and lawsuits will not have a material adverse effect on the financial position of the Corporation.

The Bank participates in the Washington State Public Depository program. Prior to February 2009, financial institutions that participated in this program were part of the collateral pool that was established to protect public deposits. As a participating institution, the Corporation was responsible for its pro rata share of restoring the public deposit funds for any uninsured public deposits held in a failed financial institution. In February 2009, new standards were adopted which require institutions to collateralize uninsured public deposits at 100 percent. At December 31, 2011 and 2010, the Corporation had pledged investment securities with a carrying amount of \$976,000 and \$1,262,000, respectively, to secure public deposits. Refer to Note 4 for additional information.



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**Note 14**    **Lines of Credit**

The Corporation has established an unsecured line of credit in the amount of \$3,000,000 for overnight purchase of federal funds. This line may be cancelled without prior notification. There were no outstanding balances on this line of credit at December 31, 2011 and 2010.

The Corporation also has a credit line with the Federal Home Loan Bank of Seattle totaling 25% of pledged assets which had available borrowings of \$33,697,000 at December 31, 2011. At December 31, 2011 and 2010, the outstanding balance on this line of credit was \$500,000. See Note 9 for additional information.

**Note 15**    **Concentration of Credit Risk**

The Corporation maintains its cash accounts with several correspondent banks. Generally, accounts are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000 per bank. In addition, the FDIC insurance coverage has temporarily increased to 100% for noninterest-bearing checking accounts. At December 31, 2011, the Corporation had uninsured deposits in other financial institutions totaling \$1,500,000. Furthermore, federal funds sold are essentially uncollateralized loans to other financial institutions. Management regularly evaluates the credit risk associated with the counterparties to these transactions and believes that the Corporation is not exposed to any significant credit risks on cash and cash equivalents.

The Corporation has credit risk exposure, including off-balance-sheet credit risk exposure, as disclosed in Notes 5 and 11. Most of the Corporation's business activity is with customers located in the state of Washington. The ultimate collectibility of a substantial portion of the loan portfolio is susceptible to changes in economic and market conditions in the region. The Corporation generally requires collateral on all real estate loans and typically maintains loan-to-value ratios of no greater than 75% to 80%. Loans are generally limited, by state banking regulations, to 20% of the Bank's shareholder's equity, excluding accumulated other comprehensive income (loss). The Corporation, as a matter of practice, generally does not extend credit to any single borrower or group of related borrowers in excess of \$3,000,000.

The contractual amounts of credit related financial instruments such as commitments to extend credit and letters of credit represent the amounts of potential accounting loss should the contract be fully drawn upon, the customer defaults and the value of any existing collateral becomes worthless. Letters of credit are granted primarily to commercial borrowers.

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**Note 16 Stock Compensation Plans**

During 2009, the Board of Directors adopted the “2009 Employee Stock Option and Equity Compensation Plan”. This Plan was approved at the 2009 annual shareholders’ meeting. This Plan provides for stock awards in the form of stock options, restricted stock grants, restricted stock units and stock appreciation rights. The Plan allows for both incentive and non-qualified stock options to be granted. The Corporation may grant up to 65,000 shares under this Plan to certain key employees and directors. At December 31, 2011, there were 53,364 shares available for grant under this Plan. The exercise price of options and the value of other awards is equal to the fair market value of the Corporation’s stock on the date of grant. The maximum term of stock options is ten years. During 2011 and 2010, the Corporation entered into “Restricted Stock Award Agreements” with certain of its executive officers. These awards vest ratably over a period of three years from the date of grant. A summary of the Corporation’s restricted stock awards and activity for the years ending December 31, 2011 and 2010 is presented below:

	<b>Restricted Shares</b>	<b>Weighted- Average Grant Date Fair Value</b>
Outstanding at January 1, 2010	-	\$ -
Granted	733	47.00
Forfeited	-	-
Vested	-	-
Non-vested at December 31, 2010	<u>733</u>	<u>\$ 47.00</u>
Outstanding at January 1, 2011	733	\$ 47.00
Granted	903	52.00
Forfeited	-	-
Vested	<u>(245)</u>	<u>47.00</u>
Non-vested at December 31, 2011	<u>1,391</u>	<u>\$ 50.25</u>

Under the provisions of the Plan, grantees of restricted stock awards have all the rights of a shareholder (including voting, dividend and liquidation rights). Stock compensation expense totaling \$25,000 and \$10,000 was recorded during 2011 and 2010 relating to restricted stock awards. At December 31, 2011, there was \$47,000 in unrecognized compensation expense relating to these awards that is expected to be recognized over a period of 2.1 years.

Prior to the adoption of this Plan, the Corporation had two share-based compensation plans. Under these two stock option plans, the Corporation may grant both incentive and non-qualified options for up to 56,745 shares of its common stock to certain key employees and directors. The exercise price of each option equals the fair market value of the Corporation’s stock on the date of grant, and an option’s maximum term is ten years. Options vest 20% annually for five years. These plans were terminated with the adoption of the “2009 Employee Stock Option and Equity Compensation Plan.” The termination of these plans does not affect the terms of any outstanding options under these plans.

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**Note 16 Stock Compensation Plans, continued**

The compensation cost that has been charged against income for these plans was \$7,000 and \$15,000 for the years ended December 31, 2011 and 2010, respectively. Since the Corporation made the Subchapter S election effective January 1, 2006, there is no tax benefit recognized in the income statement for share-based compensation arrangements for the years ended December 31, 2011 and 2010.

The Corporation accounts for stock-based awards to employees and directors using the fair value method, in accordance with accounting guidance issued by the FASB. The Corporation uses the Black-Scholes valuation model to estimate the fair value of stock option awards. The following assumptions are used in the Black-Scholes model: expected volatility, expected dividends, expected term and risk-free rate. Expected volatilities are based on the historical volatility of the Corporation's stock and other factors. The Corporation uses historical data to estimate option exercise and employee termination within the model. The expected term of options granted is determined from the output of the option valuation model and management's experience and represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. The assumptions are determined at the date of grant and are not subsequently adjusted for actual. There were no stock options granted during 2011 or 2010.

A summary of option activity under the Plans as of December 31, 2011 and 2010, and changes during the years then ended, are presented below:

<u>Options</u>	<u>Shares</u>	<u>Weighted- Average Exercise Price</u>	<u>Weighted- Average Remaining Contractual Term</u>
Outstanding at January 1, 2010	18,600	\$ 37.37	
Granted	-	-	
Exercised	(4,900)	27.45	
Forfeited or expired	-	-	
Outstanding at December 31, 2010	<u>13,700</u>	<u>\$ 40.91</u>	<u>7.43</u>
Vested or expected to vest at December 31, 2010	<u>13,700</u>	<u>\$ 40.91</u>	<u>7.43</u>
Exercisable at December 31, 2010	<u>4,700</u>	<u>\$ 37.34</u>	<u>6.48</u>
Outstanding at January 1, 2011	13,700	\$ 40.91	
Granted	-	-	
Exercised	(1,200)	31.67	
Forfeited or expired	-	-	
Outstanding at December 31, 2011	<u>12,500</u>	<u>\$ 41.80</u>	<u>6.68</u>
Vested or expected to vest at December 31, 2011	<u>12,500</u>	<u>\$ 41.80</u>	<u>6.68</u>
Exercisable at December 31, 2011	<u>6,500</u>	<u>\$ 39.77</u>	<u>6.16</u>

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**Note 16 Stock Compensation Plans, continued**

There were no options granted during 2011 or 2010. The proceeds from options exercised were \$38,000 and \$135,000 in 2011 and 2010, respectively.

A summary of the status of the Corporation's nonvested shares relating to stock options as of December 31, 2011, and changes during the year then ended, is presented below:

<u>Nonvested Shares</u>	<u>Shares</u>	<u>Weighted- Average Grant-Date Fair Value</u>
Nonvested at January 1, 2011	9,000	\$ 2.42
Granted	-	-
Vested	(3,000)	5.21
Forfeited	-	-
Nonvested at December 31, 2011	<u>6,000</u>	<u>\$ 1.02</u>

As of December 31, 2011, there was \$3,000 of total unrecognized compensation cost related to nonvested shares of stock options granted under the Plans. That cost is expected to be recognized over a weighted-average period of 2.25 years.

**Note 17 Employee Benefit Plan**

The Corporation established a KSOP plan in 2005 which has a 401(k) component and an ESOP component. The Corporation has the option to make discretionary matching contributions to this plan. Beginning in 2008, the Corporation matched 50% of employee contributions to the 401(k) component of the plan up to a maximum match of \$1,500. The Corporation's discretionary contributions for the years ended December 31, 2011 and 2010 were \$44,000 and \$31,000, respectively. At December 31, 2011 and 2010, the ESOP component of this plan held 30,541 and 28,624 shares, respectively, of the Corporation's stock.

**Note 18 Regulatory Matters**

Banks are subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory (and possibly additional discretionary) actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under the regulatory capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital adequacy 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 under the prompt corrective action guidelines are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

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**Note 18 Regulatory Matters, continued**

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of: total risk-based capital and Tier 1 capital to risk-weighted assets (as defined in the regulations), and Tier 1 capital to adjusted total assets (as defined). Management believes, as of December 31, 2011 that the Bank meets all capital adequacy requirements to which it is subject.

Community First Bank has been notified by its regulators that, as of its most recent regulatory examination, it is regarded as well capitalized under the regulatory framework for prompt corrective action. Such determination has been made based on the Bank's Tier 1, total capital and leverage ratios. There have been no conditions or events since this notification that management believes would change the Bank's categorization as well capitalized under the ratios listed below.

The Bank's actual and required capital amounts and ratios are as follows:

	<u>Actual</u>		<u>Minimum Required for Capital Adequacy Purposes</u>		<u>Required to be Well Capitalized under the Prompt Corrective Action Provisions</u>	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2011:						
Total Risk-based Capital (to Risk-weighted Assets)	\$ 20,186	16.22%	\$ 9,955	8.00%	\$ 12,443	10.00%
Tier 1 Capital (to Risk-weighted Assets)	\$ 18,628	14.97%	\$ 4,977	4.00%	\$ 7,466	6.00%
Tier 1 Capital (to Adjusted Total Assets)	\$ 18,628	9.33%	\$ 7,990	4.00%	\$ 9,988	5.00%
As of December 31, 2010:						
Total Risk-based Capital (to Risk-weighted Assets)	\$ 19,083	15.56%	\$ 9,812	8.00%	\$ 12,265	10.00%
Tier 1 Capital (to Risk-weighted Assets)	\$ 17,550	14.31%	\$ 4,906	4.00%	\$ 7,359	6.00%
Tier 1 Capital (to Adjusted Total Assets)	\$ 17,550	10.38%	\$ 6,760	4.00%	\$ 8,450	5.00%

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**Note 19 Fair Values of Financial Instruments**

The estimated fair values of the Corporation's financial instruments as of December 31, 2011 and 2010 are as follows (in thousands):

	2011		2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<b>Financial assets:</b>				
Cash and due from banks	\$ 1,061	\$ 1,061	\$ 938	\$ 938
Interest-bearing deposits	52,561	52,906	24,749	24,844
Investment securities	20,680	20,680	25,362	25,362
FHLB stock	229	229	229	229
Loans held-for-sale	261	261	417	417
Loans, net	116,672	110,821	112,274	124,137
Bank-owned life insurance	3,774	3,774	2,172	2,172
Interest receivable	712	712	563	563
<b>Financial liabilities:</b>				
Deposits	179,628	180,073	151,361	154,183
Short-term borrowings	-	-	450	450
FHLB advances	500	500	500	500
Other long-term borrowings	2,164	2,164	2,786	2,786
Interest payable	105	105	155	155

The carrying amounts in the preceding table are included in the balance sheet under the applicable captions.

**Note 20 Fair Value Measurements**

The Corporation has adopted authoritative guidance issued by the FASB regarding fair value measurements for financial assets and financial liabilities. The authoritative guidance defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements.

The authoritative guidance issued by the FASB defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

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**Note 20 Fair Value Measurements, continued**

The authoritative guidance issued by the FASB requires the use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement cost). Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In that regard, the authoritative guidance establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

- **Level 1 Inputs:** Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.
- **Level 2 Inputs:** Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatilities, prepayment speeds, credit risks, etc.) or inputs that are derived principally from or corroborated by market data by correlation or other means.
- **Level 3 Inputs:** Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality and the Corporation's creditworthiness, among other things, as well as unobservable parameters. Any such valuation adjustments are applied consistently over time. The Corporation's valuation methodologies may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. While management believes the Corporation's valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

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**Note 20 Fair Value Measurements, continued**

**Securities Available-for-Sale:** U.S. Treasury securities are reported at fair value utilizing Level 1 inputs. Other securities classified as available-for-sale are reported at fair value utilizing Level 2 inputs. For these securities, the Corporation obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things.

**Impaired Loans:** Certain impaired loans are reported at the fair value of the underlying collateral if repayment is expected solely from the collateral. Collateral values are estimated using Level 2 inputs based on observable market data or Level 3 inputs based on customized discounting criteria.

**Other Real Estate:** Other real estate represents foreclosed assets that are reported at the fair value less estimated selling costs of the underlying property. The fair values are estimated using Level 2 inputs based on observable market data or Level 3 inputs based on information obtained from customized discounting criteria.

The following table summarizes financial assets and liabilities measured at fair value on a recurring basis as of December 31, 2011 and 2010, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure the fair value (in thousands):

	<u>Level 1 Inputs</u>	<u>Level 2 Inputs</u>	<u>Level 3 Inputs</u>	<u>Total Fair Value</u>
<b>December 31, 2011:</b>				
Available-For-Sale				
U.S. government agencies	\$ -	\$ 8,480	\$ -	\$ 8,480
U.S. government agency mortgage-backed securities	-	2,099	-	2,099
Collateralized mortgage obligations	-	4,037	-	4,037
Obligations of states and political subdivisions	-	4,550	-	4,550
Corporate bonds	-	1,514	-	1,514
Totals	<u>\$ -</u>	<u>\$ 20,680</u>	<u>\$ -</u>	<u>\$ 20,680</u>
<b>December 31, 2010:</b>				
Available-For-Sale				
U.S. government agencies	\$ -	\$ 20,143	\$ -	\$ 20,143
U.S. government agency mortgage-backed securities	-	1,861	-	1,861
Collateralized mortgage obligations	-	534	-	534
Obligations of states and political subdivisions	-	1,302	-	1,302
Corporate bonds	-	1,522	-	1,522
Totals	<u>\$ -</u>	<u>\$ 25,362</u>	<u>\$ -</u>	<u>\$ 25,362</u>



**COMMUNITY FIRST BANCORPORATION, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2011 AND 2010**

**Note 20 Fair Value Measurements, continued**

Certain financial assets are measured at fair value on a non-recurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). Financial assets measured at fair value on a non-recurring basis include certain impaired loans reported at the fair value of the underlying collateral if repayment is expected solely from the collateral. Collateral values are estimated using Level 2 inputs based on observable market data or Level 3 inputs based on customized discounting criteria.

The following table summarizes financial assets measured at fair value on a non-recurring basis as of December 31, 2011 and 2010, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure the fair value (in thousands):

	<u>Level 1 Inputs</u>	<u>Level 2 Inputs</u>	<u>Level 3 Inputs</u>	<u>Total Fair Value</u>
<b>December 31, 2011:</b>				
Impaired loans	\$ -	\$ -	\$ 2,050	\$ 2,050
Less specific valuation allowance for possible loan losses	-	-	(60)	(60)
Impaired loans, net	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,990</u>	<u>\$ 1,990</u>
<b>December 31, 2010:</b>				
Impaired loans	\$ -	\$ -	\$ 1,456	\$ 1,456
Less specific valuation allowance for possible loan losses	-	-	(106)	(106)
Impaired loans, net	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,350</u>	<u>\$ 1,350</u>

Certain nonfinancial assets are measured at fair value on a non-recurring basis. Nonfinancial assets measured at fair value on a non-recurring basis include other real estate which, upon initial recognition, are remeasured and reported at fair value through a charge-off to the allowance for loan losses and certain other real estate, which subsequent to their initial recognition, are remeasured at fair value through a writedown included in other non-interest expense. The fair value of other real estate is estimated using Level 2 inputs based on observable market data or Level 3 inputs based on customized discounting criteria. At December 31, 2011 and 2010, there was no other real estate.

**OTHER FINANCIAL INFORMATION**

**COMMUNITY FIRST BANCORPORATION, INC. AND SUBSIDIARY**  
**CONSOLIDATING BALANCE SHEET**  
**DECEMBER 31, 2011**  
**(Dollars in Thousands)**

	COMMUNITY FIRST BANCORP.	COMMUNITY FIRST BANK	ELIMINATIONS	CONSOLIDATED BALANCES 2011
<b>ASSETS</b>				
Cash and due from banks	\$ 23	\$ 1,061	\$ (23)	\$ 1,061
Interest-bearing deposits in financial institutions maturing in less than three months	-	36,661	-	36,661
Total cash and cash equivalents	23	37,722	(23)	37,722
Interest-bearing deposits in financial institutions maturing in more than three months	-	15,900	-	15,900
Investment in subsidiary	19,341	-	(19,341)	-
Investment securities	-	20,680	-	20,680
Federal Home Loan Bank stock, at cost	-	229	-	229
Loans held-for-sale	-	261	-	261
Loans, net of allowance for loan losses	-	116,672	-	116,672
Bank premises and equipment, net of accumulated depreciation	-	2,902	-	2,902
Bank-owned life insurance	-	3,774	-	3,774
Accrued interest receivable	-	712	-	712
Goodwill	-	489	-	489
Other assets	-	472	-	472
<b>Total Assets</b>	<b>\$ 19,364</b>	<b>\$ 199,813</b>	<b>\$ (19,364)</b>	<b>\$ 199,813</b>
<b>LIABILITIES</b>				
Deposits	\$ -	\$ 179,651	\$ (23)	\$ 179,628
Advances from Federal Home Loan Bank	-	500	-	500
Other long-term borrowings	2,164	-	-	2,164
Other liabilities:				
Accrued interest payable	8	97	-	105
Accrued expenses and other liabilities	-	224	-	224
Total other liabilities	8	321	-	329
<b>Total Liabilities</b>	<b>2,172</b>	<b>180,472</b>	<b>(23)</b>	<b>182,621</b>
<b>SHAREHOLDERS' EQUITY</b>				
Common stock, \$1 par value:				
Authorized - 1,000,000 shares				
Issued and outstanding - 443,705 shares	444	401	(401)	444
Additional paid-in capital	10,412	11,623	(11,623)	10,412
Retained earnings	6,112	7,093	(7,093)	6,112
Accumulated other comprehensive income	224	224	(224)	224
<b>Total Shareholders' Equity</b>	<b>17,192</b>	<b>19,341</b>	<b>(19,341)</b>	<b>17,192</b>
<b>Total Liabilities and Shareholders' Equity</b>	<b>\$ 19,364</b>	<b>\$ 199,813</b>	<b>\$ (19,364)</b>	<b>\$ 199,813</b>

See Independent Auditor's Report.

**COMMUNITY FIRST BANCORPORATION, INC. AND SUBSIDIARY**  
**CONSOLIDATING STATEMENT OF INCOME**  
**FOR THE YEAR ENDED DECEMBER 31, 2011**  
(Dollars in Thousands)

	COMMUNITY FIRST BANCORP.	COMMUNITY FIRST BANK	ELIMINATIONS	CONSOLIDATED BALANCES 2011
<b>Interest income</b>				
Interest and fees on loans	\$ -	\$ 7,829	\$ -	\$ 7,829
Interest on investment securities	-	405	-	405
Interest on federal funds sold and interest-bearing deposits with financial institutions	-	179	-	179
Total interest income	-	8,413	-	8,413
<b>Interest expense</b>				
On deposits	-	736	-	736
On borrowed funds	109	25	-	134
Total interest expense	109	761	-	870
Net interest income (expense)	(109)	7,652	-	7,543
Provision for loan losses	-	98	-	98
Net interest income (expense) after provision for loan losses	(109)	7,554	-	7,445
<b>Non-interest income</b>				
Service charges and fees on deposit accounts	-	316	-	316
Equity in undistributed income of subsidiary	1,046	-	(1,046)	-
Dividend income from subsidiary	2,126	-	(2,126)	-
Mortgage broker fees	-	125	-	125
Earnings on bank-owned life insurance	-	102	-	102
Gain on sales of investment securities	-	82	-	82
Net gain on sales of loans	-	191	-	191
Other	-	312	-	312
Total non-interest income	3,172	1,128	(3,172)	1,128
<b>Non-interest expense</b>				
Salaries and employee benefits	4	3,533	-	3,537
Occupancy	-	368	-	368
Furniture and equipment	-	159	-	159
Data processing	-	291	-	291
Professional fees	1	253	-	254
Other operating expenses	-	906	-	906
Total non-interest expense	5	5,510	-	5,515
<b>Net Income</b>	<b>\$ 3,058</b>	<b>\$ 3,172</b>	<b>\$ (3,172)</b>	<b>\$ 3,058</b>

See Independent Auditor's Report.

**COMMUNITY FIRST BANK  
BALANCE SHEETS  
(BANK ONLY)  
DECEMBER 31, 2011 AND 2010  
(Dollars in Thousands)**

	<b>2011</b>	<b>2010</b>
<b>ASSETS</b>		
Cash and cash equivalents:		
Cash and due from banks	\$ 1,061	\$ 938
Interest-bearing deposits in financial institutions maturing in less than three months	36,661	10,979
Total cash and cash equivalents	37,722	11,917
Interest-bearing deposits in financial institutions maturing in more than three months	15,900	13,770
Investment securities	20,680	25,362
Federal Home Loan Bank stock, at cost	229	229
Loans held-for-sale	261	417
Loans, net of allowance for loan losses	116,672	112,274
Bank premises and equipment, net of accumulated depreciation	2,902	2,991
Bank-owned life insurance	3,774	2,172
Accrued interest receivable	712	563
Goodwill	489	489
Other assets	472	516
<b>Total Assets</b>	<b>\$ 199,813</b>	<b>\$ 170,700</b>
 <b>LIABILITIES</b>		
Deposits	\$ 179,651	\$ 151,391
Short-term borrowings	-	450
Advances from Federal Home Loan Bank	500	500
Other liabilities:		
Accrued interest payable	97	130
Accrued expenses and other liabilities	224	172
Total other liabilities	321	302
<b>Total Liabilities</b>	<b>180,472</b>	<b>152,643</b>
 <b>SHAREHOLDER'S EQUITY</b>		
Common stock, \$1 par value:		
Authorized - 1,000,000 shares		
Issued and outstanding - 400,630 shares	401	401
Additional paid-in capital	11,623	11,591
Retained earnings	7,093	6,047
Accumulated other comprehensive income	224	18
<b>Total Shareholder's Equity</b>	<b>19,341</b>	<b>18,057</b>
<b>Total Liabilities and Shareholder's Equity</b>	<b>\$ 199,813</b>	<b>\$ 170,700</b>

See Independent Auditor's Report.

**COMMUNITY FIRST BANK**  
**STATEMENTS OF INCOME**  
**(BANK ONLY)**  
**FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010**  
**(Dollars in Thousands)**

	<b>2011</b>	<b>2010</b>
<b>Interest income</b>		
Interest and fees on loans	\$ 7,829	\$ 7,929
Interest on investment securities	405	274
Interest on federal funds sold and interest-bearing deposits with financial institutions	179	143
Total interest income	8,413	8,346
<b>Interest expense</b>		
On deposits	736	933
On borrowed funds	25	25
Total interest expense	761	958
Net interest income	7,652	7,388
Provision for loan losses	98	301
Net interest income after provision for loan losses	7,554	7,087
<b>Non-interest income</b>		
Service charges and fees on deposit accounts	316	263
Mortgage broker fees	125	157
Earnings on bank-owned life insurance	102	72
Gain on sales of investment securities	82	-
Net gain on sales of loans	191	132
Other	312	256
Total non-interest income	1,128	880
<b>Non-interest expense</b>		
Salaries and employee benefits	3,533	3,117
Occupancy	368	373
Furniture and equipment	159	166
Data processing	291	260
Professional fees	253	341
Other operating expenses	906	885
Total non-interest expense	5,510	5,142
<b>Net Income</b>	<b>\$ 3,172</b>	<b>\$ 2,825</b>

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**COMMUNITY FIRST BANK**  
**STATEMENTS OF CHANGES IN SHAREHOLDER'S EQUITY**  
**(BANK ONLY)**  
**FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010**  
**(Dollars in Thousands)**

	<u>Common Stock</u>	<u>Additional Paid-In Capital</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income</u>	<u>Total</u>
Balance at January 1, 2010	\$ 401	\$ 11,566	\$ 4,730	\$ 138	\$ 16,835
Stock option compensation expense		15			15
Restricted stock compensation expense		10			10
Net income for the year ended December 31, 2010			2,825		2,825
Unrealized loss on available-for- sale securities				(120)	<u>(120)</u>
Comprehensive income					2,705
Dividends paid - \$3.76 per share			<u>(1,508)</u>		<u>(1,508)</u>
<b>Balance at December 31, 2010</b>	401	11,591	6,047	18	18,057
Stock option compensation expense		7			7
Restricted stock compensation expense		25			25
Net income for the year ended December 31, 2011			3,172		3,172
Unrealized gain on available-for- sale securities				206	<u>206</u>
Comprehensive income					3,378
Dividends paid - \$5.31 per share			<u>(2,126)</u>		<u>(2,126)</u>
<b>Balance at December 31, 2011</b>	<u>\$ 401</u>	<u>\$ 11,623</u>	<u>\$ 7,093</u>	<u>\$ 224</u>	<u>\$ 19,341</u>

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**COMMUNITY FIRST BANK**  
**STATEMENTS OF CASH FLOWS**  
**(BANK ONLY)**  
**FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010**  
**(Dollars in Thousands)**

	<b>2011</b>	<b>2010</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 3,172	\$ 2,825
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	236	264
Provision for loan losses	98	301
Net amortization on investment securities	264	163
Stock option compensation expense	7	15
Restricted stock compensation expense	25	10
Earnings on bank-owned life insurance	(102)	(72)
Gain on sales of investment securities	(82)	-
Originations of loans held-for-sale	(15,294)	(11,853)
Proceeds from sales of loans held-for-sale	15,641	11,568
Net gain on sales of loans	(191)	(132)
(Increase) decrease in accrued interest receivable	(149)	51
Increase (decrease) in accrued interest payable	(33)	23
Other	33	120
Total adjustments	453	458
<b>Net Cash Provided by Operating Activities</b>	<b>3,625</b>	<b>3,283</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Increase in interest-bearing deposits in financial institutions maturing in more than three months	(2,130)	(9,270)
Purchases of investment securities:		
Available-for-sale	(24,105)	(34,025)
Proceeds from maturities and calls of investment securities:		
Available-for-sale	24,110	19,950
Proceeds from sales of investment securities:		
Available-for-sale	2,250	-
Proceeds from principal paydowns on investment securities:		
Available-for-sale	2,480	1,865
Net increase in loans made to customers	(4,496)	(2,668)
Purchases of premises and equipment	(113)	(16)
Purchases of bank-owned life insurance	(1,500)	(2,100)
<b>Net Cash Used by Investing Activities</b>	<b>\$ (3,504)</b>	<b>\$ (26,264)</b>

See Independent Auditor's Report.



**COMMUNITY FIRST BANK**  
**STATEMENTS OF CASH FLOWS, Continued**  
**(BANK ONLY)**  
**FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010**  
**(Dollars in Thousands)**

	<b>2011</b>	<b>2010</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net increase in demand deposits, interest-bearing transaction accounts and savings	\$ 26,234	\$ 30,256
Net increase (decrease) in time deposits	2,026	(226)
Net increase (decrease) in short-term borrowings	(450)	75
Dividends paid	(2,126)	(1,508)
<b>Net Cash Provided by Financing Activities</b>	<b>25,684</b>	<b>28,597</b>
<b>Net increase in cash and cash equivalents</b>	<b>25,805</b>	<b>5,616</b>
<b>Cash and cash equivalents at beginning of year</b>	<b>11,917</b>	<b>6,301</b>
<b>Cash and cash equivalents at end of year</b>	<b>\$ 37,722</b>	<b>\$ 11,917</b>
 <b>SUPPLEMENTAL SCHEDULE OF OPERATING AND INVESTING ACTIVITIES:</b>		
Interest paid	\$ 794	\$ 935