COMMUNITY FIRST BANCORPORATION, INC. AND SUBSIDIARY

KENNEWICK, WA

AUDITED CONSOLIDATED FINANCIAL STATEMENTS

AND OTHER FINANCIAL INFORMATION

DECEMBER 31, 2012 AND 2011

C O N T E N T S

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.

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INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying consolidated financial statements of Community First Bancorporation, Inc. and Subsidiary, which comprise the balance sheets as of December 31, 2012 and 2011 and the related statements of comprehensive income, changes in shareholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the 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, 2012 and 2011 and the results of their operations and their cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Our audits were conducted for the purpose of forming an opinion on the financial statements taken as a whole. The other financial information on pages 43-49 is presented for the purposes of additional analysis and is not a required part of the 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 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 financial statements taken as a whole.

Stovall, Grandey & Allen, LLP

STOVALL, GRANDEY & ALLEN, L.L.P.
Fort Worth, Texas
March 10, 2013

COMMUNITY FIRST BANCORPORATION, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2012 AND 2011
(Dollars in Thousands)

	2012	2011
ASSETS		
Cash and cash equivalents:		
Cash and due from banks - Note 3	$ 933	$ 1,061
Interest-bearing deposits in financial institutions maturing in less than three months	36,428	36,661
Total cash and cash equivalents	37,361	37,722
Interest-bearing deposits in financial institutions maturing in more than three months	18,269	15,900
Investment securities - Note 4	32,572	20,680
Federal Home Loan Bank stock, at cost - Note 2	225	229
Loans held-for-sale - Note 5	774	261
Loans, net of allowance for loan losses - Note 5	128,509	116,672
Bank premises and equipment, net of accumulated depreciation - Note 6	3,014	2,902
Other real estate owned	275	-
Bank-owned life insurance	3,919	3,774
Accrued interest receivable	668	712
Goodwill	489	489
Other assets	371	472
Total Assets	$ 226,446	$ 199,813
LIABILITIES		
Deposits - Note 7	$ 204,727	$ 179,628
Advances from Federal Home Loan Bank - Note 8	500	500
Other long-term borrowings - Note 8	1,459	2,164
Other liabilities:		
Accrued interest payable	64	105
Accrued expenses and other liabilities	237	224
Total other liabilities	301	329
Total Liabilities	206,987	182,621
Commitments and contingencies - Notes 6, 10, 11, 12, 13 and 14		
SHAREHOLDERS' EQUITY		
Common stock, $1 par value:		
Authorized - 1,000,000 shares		
Issued and outstanding - 443,199 and 443,705 shares at December 31, 2012 and 2011, respectively	443	444
Additional paid-in capital	10,326	10,412
Retained earnings	8,074	6,112
Accumulated other comprehensive income	616	224
Total Shareholders' Equity	19,459	17,192
Total Liabilities and Shareholders' Equity	$ 226,446	$ 199,813

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

COMMUNITY FIRST BANCORPORATION, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011
(Dollars in Thousands, except for per share amounts)

	2012	2011
Interest income		
Interest and fees on loans	$ 7,567	$ 7,829
Interest on investment securities	355	405
Interest on federal funds sold and interest-bearing deposits with financial institutions	230	179
Total interest income	8,152	8,413
Interest expense		
On deposits	539	736
On borrowed funds	81	134
Total interest expense	620	870
Net interest income	7,532	7,543
Provision for loan losses - Note 5	-	98
Net interest income after provision for loan losses	7,532	7,445
Non-interest income		
Service charges and fees on deposit accounts	359	316
Mortgage broker fees	91	125
Earnings on bank-owned life insurance	145	102
Gain on sales of investment securities	-	82
Net gain on sales of loans	410	191
Other	354	312
Total non-interest income	1,359	1,128
Non-interest expense		
Salaries and employee benefits	3,701	3,537
Occupancy	366	368
Furniture and equipment	175	159
Data processing	296	291
Professional fees	159	254
Other operating expenses	923	906
Total non-interest expense	5,620	5,515
Net Income	3,271	3,058
Other Comprehensive Income		
Securities available-for-sale:		
Change in net unrealized gain during the year	392	206
Other comprehensive income	392	206
Comprehensive Income	$ 3,663	$ 3,264
Basic earnings per share of common stock	$ 7.35	$ 6.90
Average shares of common stock outstanding	444,950	443,170

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, 2012 AND 2011
(Dollars in Thousands)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total
Balance at January 1, 2011	$ 442	$ 10,344	$ 4,472	$ 18	$ 15,276
Exercise of stock options	1	37			38
Stock option compensation expense		7			7
Restricted stock compensation expense	1	24			25
Comprehensive income for the year ended December 31, 2011			3,058	206	3,264
Dividends paid - $3.20 per share			(1,418)		(1,418)
Balance at December 31, 2011	444	10,412	6,112	224	17,192
Purchase of stock	(4)	(204)			(208)
Exercise of stock options	2	80			82
Stock option compensation expense		1			1
Restricted stock compensation expense	1	37			38
Comprehensive income for the year ended December 31, 2012			3,271	392	3,663
Dividends paid - $2.94 per share			(1,309)		(1,309)
Balance at December 31, 2012	$ 443	$ 10,326	$ 8,074	$ 616	$ 19,459

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, 2012 AND 2011
(Dollars in Thousands)

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 3,271	$ 3,058
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	294	236
Provision for loan losses	-	98
Net amortization on investment securities	376	264
Stock option compensation expense	1	7
Restricted stock compensation expense	38	25
Earnings on bank-owned life insurance	(145)	(102)
Gain on sales of investment securities	-	(82)
Originations of loans held-for-sale	(24,930)	(15,294)
Proceeds from sales of loans held-for-sale	24,827	15,641
Net gain on sales of loans	(410)	(191)
(Increase) decrease in accrued interest receivable	44	(149)
Decrease in accrued interest payable	(41)	(50)
Other	50	33
Total adjustments	104	436
Net Cash Provided by Operating Activities	3,375	3,494
CASH FLOWS FROM INVESTING ACTIVITIES:		
Increase in interest-bearing deposits in financial institutions maturing in more than three months	(2,369)	(2,130)
Purchases of investment securities:		
Available-for-sale	(24,875)	(24,105)
Proceeds from maturities and calls of investment securities:		
Available-for-sale	9,500	24,110
Proceeds from sales of investment securities:		
Available-for-sale	-	2,250
Proceeds from principal paydowns on investment securities:		
Available-for-sale	3,499	2,480
Proceeds from redemption of FHLB stock	4	-
Net increase in loans made to customers	(12,112)	(4,496)
Purchases of premises and equipment	(342)	(113)
Purchases of bank-owned life insurance	-	(1,500)
Net Cash Used by Investing Activities	$ (26,695)	$ (3,504)

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, 2012 AND 2011
(Dollars in Thousands)

	2012	2011
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in demand deposits, interest-bearing transaction accounts and savings	$ 27,595	$ 26,241
Net increase (decrease) in time deposits	(2,496)	2,026
Net decrease in short-term borrowings	-	(450)
Proceeds from other long-term borrowings	-	2,164
Principal payments on other long-term borrowings	(705)	(2,786)
Repurchase of common stock	(208)	-
Proceeds from stock options exercised	82	38
Dividends paid	(1,309)	(1,418)
Net Cash Provided by Financing Activities	22,959	25,815
Net increase (decrease) in cash and cash equivalents	(361)	25,805
Cash and cash equivalents at beginning of year	37,722	11,917
Cash and cash equivalents at end of year	$ 37,361	$ 37,722
SUPPLEMENTAL SCHEDULE OF OPERATING AND INVESTING ACTIVITIES:		
Interest paid	$ 661	$ 920
Other real estate acquired through loan foreclosure	275	-

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.

<u>Principles of Consolidation</u>

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

<u>Nature of Operations</u>

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.

<u>Estimates</u>

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.

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.

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, 2012 and 2011, the Corporation had $225,000 and $229,000, respectively, 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 .5% of its outstanding mortgage related assets or 4.5% 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 2012 and 2011, 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.

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.

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 2012 and 2011, 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.

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, 2012 and 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, 2009 through December 31, 2012 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 2012 or 2011.

Stock-Based Compensation

The Corporation has stock-based employee compensation plans which are more fully described in Note 15. 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 $39,000 and $32,000 lower for the years ended December 31, 2012 and 2011, 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 comprehensive income.

Note 2 Summary of Significant Accounting Policies, continued

Advertising Costs

Advertising costs are expensed as incurred. Advertising costs in the amount of $46,000 and $38,000 were expensed during 2012 and 2011, 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.

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.

***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, 2012 and 2011, the book value per share is $43.91 and $38.75, 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, 2012 and 2011, the tangible book value per share is $42.80 and $37.64, 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, 2012 through March 10, 2013, 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.

Note 2 Summary of Significant Accounting Policies, continued

New Accounting Standards

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 became 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.

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 was effective for periods beginning on or after December 15, 2011 and did not 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 was effective for annual periods ending on or after December 15, 2012 and was applied retrospectively to restructurings occurring on or after January 1, 2012 and did not have a significant impact on the Corporation's financial statements.

Note 2 Summary of Significant Accounting Policies, continued

New Accounting Standards, continued

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 was effective for annual periods beginning after December 15, 2011 and did not 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 was 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 did not have a significant impact on the Corporation's financial statements.

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 was effective for annual and interim impairment tests beginning after December 15, 2011, and did not have a significant impact on the Corporation's financial statements.

ASU 2011-12, *Comprehensive Income (Topic 220) – Deferral of Effective Date for Amendments to the Presentation of Reclassifications of Items out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*, defers changes in ASU No. 2011-05 that relate to the presentation of reclassification adjustments to allow the FASB time to redeliberate whether to require presentation of such adjustments on the face of the financial statements to show the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income. ASU 2011-12 allows entities to continue to report reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before ASU No. 2011-05. All other requirements in ASU No. 2011-05 are not affected by ASU No. 2011-12. ASU 2011-12 was effective for annual periods ending after December 15, 2012 and did not have a significant impact on the Corporation's financial statements.

Note 2 Summary of Significant Accounting Policies, continued

New Accounting Standards, continued

ASU 2012-02, *Intangibles-Goodwill and Other (Topic 350) – Testing Indefinite-Lived Intangible Assets for Impairment*, permits an entity first to assess qualitative factors to determine whether it is more likely than not than an indefinite-lived intangible asset is impaired as a basis for determining whether it is necessary to perform the quantitative impairment test in accordance with Subtopic 350-30. The objective of the amendments in this Update is to reduce the cost and complexity of performing an impairment test for indefinite-lived intangible assets by simplifying how an entity tests those assets for impairment and to improve consistency in impairment testing guidance among long-lived asset categories. The amendments are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted. ASU 2012-02 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, 2012 and 2011 was $5,139,000 and $4,387,000, respectively.

Note 4 Investment Securities

The amortized cost and fair values of investment securities at December 31, 2012 are as follows (in thousands):

	December 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
U.S. Government agencies	$ 13,928	$ 162	$ (7)	$ 14,083
U.S. Government agency mortgage-backed securities	413	23	-	436
Collateralized mortgage obligations	4,955	135	-	5,090
Obligations of state and political subdivisions	12,660	357	(54)	12,963
Total available-for-sale securities	$ 31,956	$ 677	$ (61)	$ 32,572

The balance sheet as of December 31, 2012 reflects the fair value of available-for-sale securities in the amount of $32,572,000. A net unrealized gain of $616,000 is in the available-for-sale investment securities balance. The unrealized gain is included in shareholders' equity.

Note 4 Investment Securities, continued

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

	December 31, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
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	$ 20,456	$ 270	$ (46)	$ 20,680

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 value of debt securities at December 31, 2012, 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.

	Available-for-Sale	
	Amortized Cost	Fair Value
Amounts maturing in:		
After one year through five years	$ 14,290	$ 14,451
After five years through ten years	12,016	12,312
After ten years	282	283
	26,588	27,046
U.S. Government agency mortgage-backed securities	413	436
Collateralized mortgage obligations	4,955	5,090
Totals	$ 31,956	$ 32,572

Note 4 Investment Securities, continued

Investment securities with fair market values of $9,490,000 and $3,371,000 at December 31, 2012 and 2011, respectively, were pledged to secure public deposits and for other purposes as required or permitted by law.

There were no sales of investment securities during 2012. 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. During 2012, the Corporation received proceeds totaling $4,000 from the redemption of Federal Home Loan Bank (FHLB) stock. There were no redemptions of FHLB stock during 2011.

Information pertaining to securities with gross unrealized losses at December 31, 2012 and 2011, 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, 2012:						
Federal agencies	$ 2,993	$ (7)	$ -	$ -	$ 2,993	$ (7)
Municipals	3,219	(54)	-	-	3,219	(54)
Total	$ 6,212	$ (61)	$ -	$ -	$ 6,212	$ (61)
December 31, 2011:						
Federal agencies	$ 2,538	$ (46)	$ -	$ -	$ 2,538	$ (46)
Total	$ 2,538	$ (46)	$ -	$ -	$ 2,538	$ (46)

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, 2012, the seven debt securities with unrealized losses have depreciated less than 1% 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.

Note 5 Loans and Allowance for Loan Losses

An analysis of loan categories at December 31, 2012 and 2011 is as follows (in thousands):

	2012	2011
Commercial, agricultural and industrial loans	$ 22,553	$ 21,268
Real estate (RE) loans:		
Construction, land and land development	17,142	14,217
Residential 1-4 family	16,585	14,878
Commercial RE	71,569	65,309
Dealer contracts	5	47
Consumer loans	2,834	2,816
Overdrafts	103	111
	130,791	118,646
Less: Allowance for loan losses	(1,508)	(1,713)
Loans, Net	$ 129,283	$ 116,933

Residential 1-4 family loans shown above include mortgage loans held-for-sale totaling $774,000 and $261,000 at December 31, 2012 and 2011, respectively.

Note 5 Loans and Allowance for Loan Losses, continued

Transactions in the allowance for loan losses in 2012 are summarized as follows (in thousands):

	Commercial, Agricultural and Industrial	Construction, Land and Land Development	Residential 1-4 Family	Commercial RE	Consumer and Other	Unallocated	2012 Total
Allowance for Loan Losses:							
Balance, beginning of year	$ 260	$ 102	$ 122	$ 543	$ 30	$ 656	$ 1,713
Provisions, charged (credited) to income	(60)	(7)	141	(170)	163	(67)	-
	200	95	263	373	193	589	1,713
Loans charged-off	(44)	-	(34)	-	(142)	-	(220)
Recoveries of loans previously charged-off	10	-	-	-	5	-	15
Net charge-offs	(34)	-	(34)	-	(137)	-	(205)
Balance, end of year	$ 166	$ 95	$ 229	$ 373	$ 56	$ 589	$ 1,508
Ending balance: Individually evaluated for impairment	$ 29	$ -	$ 32	$ 1	$ -	$ -	$ 62
Ending balance: Collectively evaluated for impairment	137	95	197	372	56	589	1,446
Balance, end of year	$ 166	$ 95	$ 229	$ 373	$ 56	$ 589	$ 1,508
Loans:							
Ending balance: Individually evaluated for impairment	$ 33	$ -	$ 682	$ 867	$ -		$ 1,582
Ending balance: Collectively evaluated for impairment	22,520	17,142	15,903	70,702	2,942		129,209
Ending balance total loans	$ 22,553	$ 17,142	$ 16,585	$ 71,569	$ 2,942		$ 130,791

Note 5 Loans and Allowance for Loan Losses, continued

Transactions in the allowance for loan losses in 2011 are summarized as follows (in thousands):

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

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, 2012 and 2011 are as follows (in thousands):

	Pass	Other Assets Especially Mentioned	Sub-Standard	Doubtful	Total
December 31, 2012:					
Commercial, agricultural and industrial loans	$ 20,606	$ 1,793	$ 154	$ -	$ 22,553
Real estate (RE) loans:					
Construction, land and land development	15,542	1,524	76	-	17,142
Residential 1-4 family	15,586	203	796	-	16,585
Commercial RE	65,914	1,780	3,875	-	71,569
Consumer and other loans	2,888	48	6	-	2,942
Total Loans	$ 120,536	$ 5,348	$ 4,907	$ -	$ 130,791
December 31, 2011:					
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	$ 110,795	$ 2,522	$ 5,329	$ -	$ 118,646

Note 5 Loans and Allowance for Loan Losses, continued

An analysis of nonaccrual loans by category at December 31, 2012 and 2011 is as follows (in thousands):

	2012	2011
Commercial, agriculture and industrial loans	$ 15	$ -
Real estate (RE) loans:		
Construction, land and land development	-	33
Residential 1-4 family	-	1
Commercial RE	419	431
Consumer and other loans	-	14
Total nonaccrual loans	$ 434	$ 479

At December 31, 2012 and 2011, a summary of information pertaining to impaired loans is as follows (in thousands):

	Unpaid Contractual Principal Balance	Recorded Investment with No Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
December 31, 2012:							
Commercial, agriculture and industrial loans	$ 34	$ -	$ 33	$ 33	$ 29	$ 19	$ 3
Real estate (RE) loans:							
Residential 1-4 family	682	-	682	682	32	571	38
Commercial RE	943	-	867	867	1	1,219	33
Consumer and other loans	-	-	-	-	-	7	-
Total	$ 1,659	$ -	$ 1,582	$ 1,582	$ 62	$ 1,816	$ 74
December 31, 2011:							
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	17	-	15	15	1	17	-
Total	$ 2,093	$ -	$ 2,050	$ 2,050	$ 60	$ 1,753	$ 95

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

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 2012 and 2011 are set forth in the following table (in thousands):

December 31, 2012:	**Number of Contracts**	**Balance at Restructuring Date**	**Balance at December 31, 2012**
Real estate (RE) loans:			
Residential 1-4 family	1	$ 20	$ 19
Total troubled debt restructurings	1	$ 20	$ 19

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

Concessions granted on these loans include reduction of interest rates and restructuring payments to match borrower’s cash flow. At December 31, 2012 and 2011, all of these loans were paying in accordance to the restructured terms.

Note 5 Loans and Allowance for Loan Losses, continued

The following table illustrates an age analysis of past due loans as of December 31, 2012 and 2011 (in thousands):

December 31, 2012:	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans	Recorded Investment 90 Days or More and Still Accruing
Commercial, agricultural and industrial loans	$ 138	$ 7	$ 145	$ 22,408	$ 22,553	$ -
Real estate (RE) loans:						
Construction, land and land development	120	-	120	17,022	17,142	-
Residential 1-4 family	-	-	-	16,585	16,585	-
Commercial RE	52	-	52	71,517	71,569	-
Consumer and other loans	7	-	7	2,935	2,942	-
Total	$ 317	$ 7	$ 324	$ 130,467	$ 130,791	$ -
December 31, 2011:						
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	-
Total	$ 1,311	$ 47	$ 1,358	$ 117,288	$ 118,646	$ -

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, 2012 and 2011.

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, 2012 and 2011 is as follows (in thousands):

	2012	2011
Land	$ 452	$ 452
Buildings	2,533	2,529
Leasehold improvements	442	249
Furniture and equipment	1,312	1,119
Premises and equipment in process	-	48
	4,739	4,397
Less accumulated depreciation and amortization	(1,725)	(1,495)
Bank premises and equipment, net	$ 3,014	$ 2,902

Depreciation and amortization on bank premises and equipment charged to expense totaled $230,000 and $202,000 for the years ended December 31, 2012 and 2011, respectively. Computer software, net of accumulated amortization, is included in Other Assets. Amortization on computer software charged to expense totaled $64,000 and $34,000 for the years ended December 31, 2012 and 2011, 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 expired February 28, 2012 and was renewed for through February 28, 2017. This lease includes three more 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 $140,000 and $148,000 for the years ended December 31, 2012 and 2011, respectively. Included in the lease expense were amounts paid to a related party in the amount of $52,000 and $51,000 for the years ended December 31, 2012 and 2011, respectively.

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):

2013	$	144
2014		145
2015		146
2016		54
2017		9
Total	$	498

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, 2012 and 2011 are as follows (in thousands):

	2012		2011	
Demand	$	81,182	$	66,046
Interest-bearing transaction accounts		98,616		88,022
Savings		7,144		5,279
Time deposits less than $100,000		6,023		6,469
Time deposits $100,000 and over		11,762		13,812
Total deposits	$	204,727	$	179,628

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

2013	$	12,826
2014		3,417
2015		386
2016		743
2017		388
Thereafter		25
	$	17,785

At December 31, 2012, there were no brokered deposits, obtained from customers outside the Corporation's primary market area. Included in deposits at December 31, 2011 are brokered deposits, obtained from customers outside the Corporation's primary market area, totaling $189,000.

Note 8 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 only 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 $18,000 at December 31, 2012 and a blanket pledge of eligible loans with a carrying amount of $10,359,000 at December 31, 2012. Refer to Note 4 for additional information. Refer to Note 13 for additional information regarding the amount available under this borrowing line.

On November 15, 2011, the Corporation borrowed $2,164,000 from a financial institution. The loan proceeds were used to pay-off a $3,000,000 loan obtained from another financial institution during 2009. Interest on this loan is equal to the Prime rate index. At December 31, 2012 and 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. The unpaid principal balance on this loan was $1,459,000 and $2,164,000 at December 31, 2012 and 2011, respectively.

Principal payments due on long-term borrowings at December 31, 2012 for the next five years and thereafter are as follows (in thousands):

2013	$	901
2014		558
2015		-
2016		-
2017		-
Thereafter		500
	$	1,959

Note 9 Related Party Transactions

During 2012 and 2011, 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.

Note 9 Related Party Transactions, continued

A summary of these transactions follows (in thousands):

	Balance Beginning of Year	Additions	Amounts Collected	Balance End of Year
For the year ended:				
December 31, 2012	$ -	$ 46	$ (46)	$ -
December 31, 2011	$ 49	$ 118	$ (167)	$ -

The Corporation held deposits for certain of its officers, directors and principal shareholders in the amount of $22,846,000 and $23,998,000 at December 31, 2012 and 2011, 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 10 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):

	2012	2011
Commitments to extend credit	$ 28,910	$ 35,375
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.

Note 10 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 2012 or 2011. The Corporation has not incurred any material losses on its commitments in 2012 or 2011.

Note 11 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 12 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, 2012 and 2011, the Corporation had pledged investment securities with a carrying amount of $9,281,000 and $976,000, respectively, to secure public deposits. Refer to Note 4 for additional information.

Note 13 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, 2012 and 2011.

The Corporation also has a credit line with the Federal Home Loan Bank of Seattle totaling 25% of assets which had available borrowings of $4,188,000 at December 31, 2012 assuming assets are pledged accordingly. At December 31, 2012 and 2011, the outstanding balance on this line of credit was $500,000. See Note 8 for additional information.

Note 14 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 through December 31, 2012. At December 31, 2012, the Corporation had uninsured deposits in other financial institutions totaling $750,000. 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 10. 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.

Note 15 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, 2012, there were 52,665 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 2012 and 2011, 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, 2012 and 2011 is presented below:

	Restricted Shares	Weighted-Average Grant Date Fair Value
Outstanding at January 1, 2011	733	$ 47.00
Granted	903	52.00
Forfeited	-	-
Vested	(245)	47.00
Non-vested at December 31, 2011	1,391	$ 50.25
Outstanding at January 1, 2012	1,391	$ 50.25
Granted	699	56.00
Forfeited	-	-
Vested	(546)	56.00
Non-vested at December 31, 2012	1,544	$ 53.02

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 $38,000 and $25,000 was recorded during 2012 and 2011, respectively, relating to restricted stock awards. At December 31, 2012, there was $48,000 in unrecognized compensation expense relating to these awards that is expected to be recognized over a period of 2.17 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.

Note 15 Stock Compensation Plans, continued

The compensation cost that has been charged against income for these plans was $1,000 and $7,000 for the years ended December 31, 2012 and 2011, 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, 2012 and 2011.

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.

A summary of option activity under the Plans as of December 31, 2012 and 2011, and changes during the years then ended, are presented below:

Options	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term
Outstanding at January 1, 2011	13,700	$ 40.91	
Granted	-	-	
Exercised	(1,200)	31.67	
Forfeited or expired	-	-	
Outstanding at December 31, 2011	12,500	$ 41.80	6.68
Vested or expected to vest at December 31, 2011	12,500	$ 41.80	6.68
Exercisable at December 31, 2011	6,500	$ 39.77	6.16
Outstanding at January 1, 2012	12,500	$ 41.80	
Granted	-	-	
Exercised	(2,500)	33.00	
Forfeited or expired	-	-	
Outstanding at December 31, 2012	10,000	$ 44.00	6.25
Vested or expected to vest at December 31, 2012	10,000	$ 44.00	6.25
Exercisable at December 31, 2012	6,000	$ 44.00	6.25

Note 15 Stock Compensation Plans, continued

There were no options granted during 2012 or 2011. The proceeds from options exercised were $82,000 and $38,000 in 2012 and 2011, respectively.

A summary of the status of the Corporation's nonvested shares relating to stock options as of December 31, 2012, and changes during the year then ended, is presented below:

Nonvested Shares	Shares	Weighted-Average Grant-Date Fair Value
Nonvested at January 1, 2012	6,000	$ 1.02
Granted	-	-
Vested	(2,000)	1.02
Forfeited	-	-
Nonvested at December 31, 2012	4,000	$ 1.02

As of December 31, 2012, there was $2,000 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 1.25 years.

Note 16 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, 2012 and 2011 were $37,000 and $44,000, respectively. At December 31, 2012 and 2011, the ESOP component of this plan held 26,836 and 30,541 shares, respectively, of the Corporation's stock.

Note 17 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.

Note 17 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, 2012 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 (dollars in thousands):

	Actual		Minimum Required for Capital Adequacy Purposes		Required to be Well Capitalized under the Prompt Corrective Action Provisions	
	Amount	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
As of December 31, 2012:						
Total Risk-based Capital (to Risk-weighted Assets)	$ 21,308	15.42%	$ 11,052	8.00%	$ 13,816	10.00%
Tier 1 Capital (to Risk-weighted Assets)	$ 19,800	14.33%	$ 5,526	4.00%	$ 8,289	6.00%
Tier 1 Capital (to Adjusted Total Assets)	$ 19,800	8.73%	$ 9,072	4.00%	$ 11,340	5.00%
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%

Note 18 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.

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.

Note 18 Fair Value Measurements, continued

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.

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.

Note 18 Fair Value Measurements, continued

The following table summarizes financial assets and liabilities measured at fair value on a recurring basis as of December 31, 2012 and 2011, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure the fair value (in thousands):

	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
December 31, 2012:				
Available-For-Sale				
U.S. government agencies	$ -	$ 14,083	$ -	$ 14,083
U.S. government agency mortgage-backed securities	-	436	-	436
Collateralized mortgage obligations	-	5,090	-	5,090
Obligations of states and political subdivisions	-	12,963	-	12,963
Totals	$ -	$ 32,572	$ -	$ 32,572
December 31, 2011:				
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	$ -	$ 20,680	$ -	$ 20,680

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.

Note 18 Fair Value Measurements, continued

The following table summarizes financial assets measured at fair value on a non-recurring basis as of December 31, 2012 and 2011, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure the fair value (in thousands):

	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
December 31, 2012:				
Impaired loans	$ -	$ 1,582	$ -	$ 1,582
Less specific valuation allowance for possible loan losses	-	(62)	-	(62)
Impaired loans, net	$ -	$ 1,520	$ -	$ 1,520
December 31, 2011:				
Impaired loans	$ -	$ 2,050	$ -	$ 2,050
Less specific valuation allowance for possible loan losses	-	(60)	-	(60)
Impaired loans, net	$ -	$ 1,990	$ -	$ 1,990

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, 2012, the Corporation held other real estate totaling $275,000. At December 31, 2011, there was no other real estate owned by the Corporation. Fair values were determined using Level 2 measurements.

The following table presents foreclosed assets that were remeasured and reported at fair value (in thousands):

	2012
Foreclosed assets remeasured at initial recognition:	
Carrying value of foreclosed assets prior to remeasurement	$ 309
Charge-offs recognized in the allowance for loan losses	(34)
Fair Value	$ 275

During 2012, there were no writedowns recorded subsequent to foreclosure. Charge-offs recognized upon loan foreclosures are generally offset by general or specific allocations of the allowance for loan losses and generally do not significantly impact the Corporation's provision for loan losses. Regulatory guidelines require the Corporation to reevaluate the fair value of other real estate owned on at least an annual basis.

Note 19 Fair Values of Financial Instruments

The estimated fair values of the Corporation's financial instruments that are reported in the Corporation's consolidated balance sheets, segregated by the level of valuation inputs within the fair value hierarchy utilized to measure value at December 31, 2012 and 2011 are as follows (in thousands):

	2012		2011	
	Carrying Amount	**Fair Value**	**Carrying Amount**	**Fair Value**
Financial assets:				
Level 2 inputs:				
Cash and due from banks	$ 933	$ 933	$ 1,061	$ 1,061
Interest-bearing deposits	54,697	55,487	52,561	52,906
Investment securities	32,572	32,572	20,680	20,680
FHLB stock	225	225	229	229
Loans held-for-sale	774	774	261	261
Loans, net	128,509	129,523	116,672	110,821
Bank-owned life insurance	3,919	3,919	3,774	3,774
Interest receivable	668	668	712	712
Financial liabilities:				
Level 2 inputs:				
Deposits	204,727	193,089	179,628	180,073
FHLB advances	500	500	500	500
Other long-term borrowings	1,459	1,459	2,164	2,164
Interest payable	64	64	105	105

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

OTHER FINANCIAL INFORMATION

COMMUNITY FIRST BANCORPORATION, INC. AND SUBSIDIARY
CONSOLIDATING BALANCE SHEET
DECEMBER 31, 2012
(Dollars in Thousands)

	COMMUNITY FIRST BANCORP.	COMMUNITY FIRST BANK	ELIMINATIONS	CONSOLIDATED BALANCES 2012
ASSETS				
Cash and due from banks	$ 25	$ 933	$ (25)	$ 933
Interest-bearing deposits in financial institutions maturing in less than three months	-	36,428	-	36,428
Total cash and cash equivalents	25	37,361	(25)	37,361
Interest-bearing deposits in financial institutions maturing in more than three months	-	18,269	-	18,269
Investment in subsidiary	20,905	-	(20,905)	-
Investment securities	-	32,572	-	32,572
Federal Home Loan Bank stock, at cost	-	225	-	225
Loans held-for-sale	-	774	-	774
Loans, net of allowance for loan losses	-	128,509	-	128,509
Bank premises and equipment, net of accumulated depreciation	-	3,014	-	3,014
Other real estate owned	-	275	-	275
Bank-owned life insurance	-	3,919	-	3,919
Accrued interest receivable	-	668	-	668
Goodwill	-	489	-	489
Other assets	-	371	-	371
Total Assets	$ 20,930	$ 226,446	$ (20,930)	$ 226,446
LIABILITIES				
Deposits	$ -	$ 204,752	$ (25)	$ 204,727
Advances from Federal Home Loan Bank	-	500	-	500
Other long-term borrowings	1,459	-	-	1,459
Other liabilities:				
Accrued interest payable	12	52	-	64
Accrued expenses and other liabilities	-	237	-	237
Total other liabilities	12	289	-	301
Total Liabilities	1,471	205,541	(25)	206,987
SHAREHOLDERS' EQUITY				
Common stock, $1 par value:				
Authorized - 1,000,000 shares				
Issued and outstanding - 443,199 shares	443	401	(401)	443
Additional paid-in capital	10,326	11,662	(11,662)	10,326
Retained earnings	8,074	8,226	(8,226)	8,074
Accumulated other comprehensive income	616	616	(616)	616
Total Shareholders' Equity	19,459	20,905	(20,905)	19,459
Total Liabilities and Shareholders' Equity	$ 20,930	$ 226,446	$ (20,930)	$ 226,446

See Independent Auditor's Report.

COMMUNITY FIRST BANCORPORATION, INC. AND SUBSIDIARY
CONSOLIDATING STATEMENT OF INCOME
FOR THE YEAR ENDED DECEMBER 31, 2012
(Dollars in Thousands)

	COMMUNITY FIRST BANCORP.	COMMUNITY FIRST BANK	ELIMINATIONS	CONSOLIDATED BALANCES 2012
Interest income				
Interest and fees on loans	$ -	$ 7,567	$ -	$ 7,567
Interest on investment securities	-	355	-	355
Interest on federal funds sold and interest-bearing deposits with financial institutions	-	230	-	230
Total interest income	-	8,152	-	8,152
Interest expense				
On deposits	-	539	-	539
On borrowed funds	56	25	-	81
Total interest expense	56	564	-	620
Net interest income (expense)	(56)	7,588	-	7,532
Provision for loan losses	-	-	-	-
Net interest income (expense) after provision for loan losses	(56)	7,588	-	7,532
Non-interest income				
Service charges and fees on deposit accounts	-	359	-	359
Equity in undistributed income of subsidiary	1,133	-	(1,133)	-
Dividend income from subsidiary	2,194	-	(2,194)	-
Mortgage broker fees	-	91	-	91
Earnings on bank-owned life insurance	-	145	-	145
Net gain on sales of loans	-	410	-	410
Other	-	354	-	354
Total non-interest income	3,327	1,359	(3,327)	1,359
Non-interest expense				
Salaries and employee benefits		3,701	-	3,701
Occupancy	-	366	-	366
Furniture and equipment	-	175	-	175
Data processing	-	296	-	296
Professional fees		159	-	159
Other operating expenses	-	923	-	923
Total non-interest expense	-	5,620	-	5,620
Net Income	$ 3,271	$ 3,327	$ (3,327)	$ 3,271

See Independent Auditor's Report.

COMMUNITY FIRST BANK
BALANCE SHEETS
(BANK ONLY)
DECEMBER 31, 2012 AND 2011
(Dollars in Thousands)

	2012	2011
ASSETS		
Cash and cash equivalents:		
Cash and due from banks	$ 933	$ 1,061
Interest-bearing deposits in financial institutions maturing in less than three months	36,428	36,661
Total cash and cash equivalents	37,361	37,722
Interest-bearing deposits in financial institutions maturing in more than three months	18,269	15,900
Investment securities	32,572	20,680
Federal Home Loan Bank stock, at cost	225	229
Loans held-for-sale	774	261
Loans, net of allowance for loan losses	128,509	116,672
Bank premises and equipment, net of accumulated depreciation	3,014	2,902
Other real estate owned	275	-
Bank-owned life insurance	3,919	3,774
Accrued interest receivable	668	712
Goodwill	489	489
Other assets	371	472
Total Assets	$ 226,446	$ 199,813
LIABILITIES		
Deposits	$ 204,752	$ 179,651
Advances from Federal Home Loan Bank	500	500
Other liabilities:		
Accrued interest payable	52	97
Accrued expenses and other liabilities	237	224
Total other liabilities	289	321
Total Liabilities	205,541	180,472
SHAREHOLDER'S EQUITY		
Common stock, $1 par value:		
Authorized - 1,000,000 shares		
Issued and outstanding - 400,630 shares	401	401
Additional paid-in capital	11,662	11,623
Retained earnings	8,226	7,093
Accumulated other comprehensive income	616	224
Total Shareholder's Equity	20,905	19,341
Total Liabilities and Shareholder's Equity	$ 226,446	$ 199,813

See Independent Auditor's Report.

COMMUNITY FIRST BANK
STATEMENTS OF INCOME
(BANK ONLY)
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011
(Dollars in Thousands)

	2012	2011
Interest income		
Interest and fees on loans	$ 7,567	$ 7,829
Interest on investment securities	355	405
Interest on federal funds sold and interest-bearing deposits with financial institutions	230	179
Total interest income	8,152	8,413
Interest expense		
On deposits	539	736
On borrowed funds	25	25
Total interest expense	564	761
Net interest income	7,588	7,652
Provision for loan losses	-	98
Net interest income after provision for loan losses	7,588	7,554
Non-interest income		
Service charges and fees on deposit accounts	359	316
Mortgage broker fees	91	125
Earnings on bank-owned life insurance	145	102
Gain on sales of investment securities	-	82
Net gain on sales of loans	410	191
Other	354	312
Total non-interest income	1,359	1,128
Non-interest expense		
Salaries and employee benefits	3,701	3,533
Occupancy	366	368
Furniture and equipment	175	159
Data processing	296	291
Professional fees	159	253
Other operating expenses	923	906
Total non-interest expense	5,620	5,510
Net Income	$ 3,327	$ 3,172

See Independent Auditor's Report.

COMMUNITY FIRST BANK
STATEMENTS OF CHANGES IN SHAREHOLDER'S EQUITY
(BANK ONLY)
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011
(Dollars in Thousands)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total
Balance at January 1, 2011	$ 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	206
Dividends paid - $5.31 per share			(2,126)		(2,126)
Balance at December 31, 2011	401	11,623	7,093	224	19,341
Stock option compensation expense		1			1
Restricted stock compensation expense		38			38
Net income for the year ended December 31, 2012			3,327		3,327
Unrealized gain on available-for-sale securities				392	392
Dividends paid - $5.47 per share			(2,194)		(2,194)
Balance at December 31, 2012	$ 401	$ 11,662	$ 8,226	$ 616	$ 20,905

See Independent Auditor's Report.

COMMUNITY FIRST BANK
STATEMENTS OF CASH FLOWS
(BANK ONLY)
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011
(Dollars in Thousands)

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 3,327	$ 3,172
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	294	236
Provision for loan losses	-	98
Net amortization on investment securities	376	264
Stock option compensation expense	1	7
Resticted stock compensation expense	38	25
Earnings on bank-owned life insurance	(145)	(102)
Gain on sales of investment securities	-	(82)
Originations of loans held-for-sale	(24,930)	(15,294)
Proceeds from sales of loans held-for-sale	24,827	15,641
Net gain on sales of loans	(410)	(191)
(Increase) decrease in accrued interest receivable	44	(149)
Decrease in accrued interest payable	(45)	(33)
Other	50	33
Total adjustments	100	453
Net Cash Provided by Operating Activities	3,427	3,625
CASH FLOWS FROM INVESTING ACTIVITIES:		
Increase in interest-bearing deposits in financial institutions maturing in more than three months	(2,369)	(2,130)
Purchases of investment securities:		
Available-for-sale	(24,875)	(24,105)
Proceeds from maturities and calls of investment securities:		
Available-for-sale	9,500	24,110
Proceeds from sales of investment securities:		
Available-for-sale	-	2,250
Proceeds from principal paydowns on investment securities:		
Available-for-sale	3,499	2,480
Proceeds from redemptions of FHLB stock	4	-
Net increase in loans made to customers	(12,112)	(4,496)
Purchases of premises and equipment	(342)	(113)
Purchases of bank-owned life insurance	-	(1,500)
Net Cash Used by Investing Activities	$ (26,695)	$ (3,504)

See Independent Auditor's Report.

COMMUNITY FIRST BANK
STATEMENTS OF CASH FLOWS, Continued
(BANK ONLY)
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011
(Dollars in Thousands)

	2012	2011
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in demand deposits, interest-bearing transaction accounts and savings	$ 27,597	$ 26,234
Net increase (decrease) in time deposits	(2,496)	2,026
Net decrease in short-term borrowings	-	(450)
Dividends paid	(2,194)	(2,126)
Net Cash Provided by Financing Activities	22,907	25,684
Net increase (decrease) in cash and cash equivalents	(361)	25,805
Cash and cash equivalents at beginning of year	37,722	11,917
Cash and cash equivalents at end of year	$ 37,361	$ 37,722
SUPPLEMENTAL SCHEDULE OF OPERATING AND INVESTING ACTIVITIES:		
Interest paid	$ 609	$ 794
Other real estate acquired through loan foreclosure	275	-