# 2017 ANNUAL REPORT

*Investing Today for Tomorrow's Memories*

JEFFERSON SECURITY BANK
JSB
BUILDING COMMUNITY

## Our Mission

We are a community bank that partners with our customers to enhance their lives and enrich our communities through local decision-making.

# Letter To Shareholders

The shift in culture at Jefferson Security Bank is taking shape and exciting times are ahead. Over the last two years, while serving as President and CEO, our team has diligently worked through many changes and know more are on the horizon. Every step of the way, we are reminded of what made our community bank what it is today and what we want it to be for years to come – *the bank of choice in the communities we serve.* Our commitment to our communities is genuine, and our actions to build value in your investment and prepare for our future are intentional.

To summarize our financial results for the year ended December 31, 2017, net income increased 6% to $1.43 million resulting in book value of $80.85 per share when compared to the same period ended in 2016 with net income of $1.35 million and book value of $76.35 per share. Of notable mention is the increase in net income before income tax expense of 46% to $2.29 million for the year ended December 31, 2017 from $1.57 million for the year ended 2016. The enactment of the Tax Cuts and Jobs Act in December 2017 resulted in a one-time tax adjustment of $385 thousand that significantly increased our tax expense for 2017 and reduced our net income below what we had anticipated. Without this adjustment, net income for the year ended December 31, 2017 would have totaled $1.82 million, a 35% increase over the year ended December 31, 2016.

The increase in net income during 2017 resulted primarily from the implementation of our ongoing strategy to maintain our total asset position while shifting assets from our investment portfolio to our loan portfolio in order enhance our earning potential. For the second year in a row, our net loans grew over 12%. This brings our gross loan total to the highest level in our history at $175.6 million as of December 31, 2017 and has resulted in a net loan to deposit ratio of 65%. While growing our loan portfolio, we have maintained strong underwriting, continued our commitment to high quality standards and dedicated efforts to actively manage potential problems as they arise. When comparing the year ended December 31, 2017 to the same period in 2016, we have seen an overall reduction in our problem assets with respect to past due, nonaccrual and troubled debt restructured loans. Additionally, all previously foreclosed properties held as other real estate owned were sold and no properties were held as of December 31, 2017.

Throughout 2018, our strategy will incorporate a more comprehensive approach to building customer relationships as we continue to explore opportunities to enhance each customer experience by offering the loan and deposit products and services that meet our customer needs. Maintaining our focus on the loan to deposit ratio, will allow us to obtain a more optimal asset distribution to enhance our profitability and grow value. We appreciate the support of our shareholders, customers and communities and look forward to having a meaningful impact on the lives in the communities we serve.

Sincerely,

Cindy A. Kitner

Cindy A. Kitner, CPA
President and CEO

# Board of Directors

Left to Right Back row: Christian E. Asam; Eric J. Lewis, CPA, Vice Chair; Dennis L. Barron; Brant M. Lowe; Front Row: R. Andrew McMillan, Jr.; Suellen D. Myers; Monica W. Lingenfelter, Corporate Secretary; Cindy A. Kitner, CPA, President and CEO; Frederick K. Parsons, Chair.

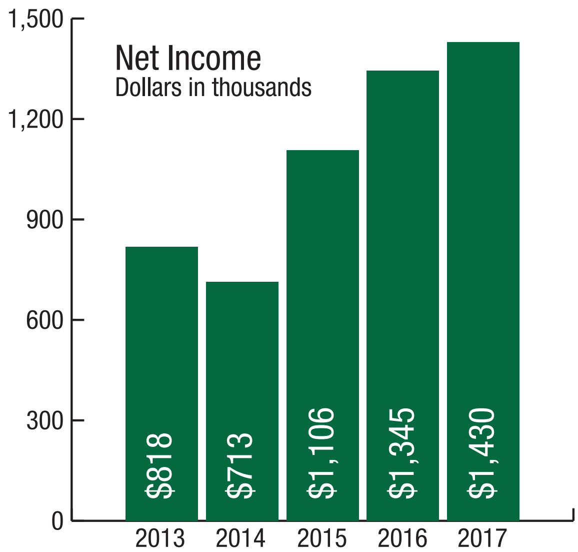
# Executive Vice Presidents

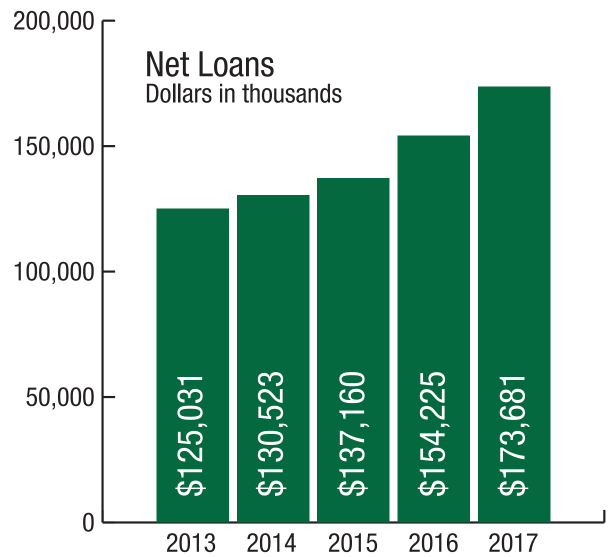
Jenna L. Kesecker, CPA
Executive Vice President and Chief Financial Officer

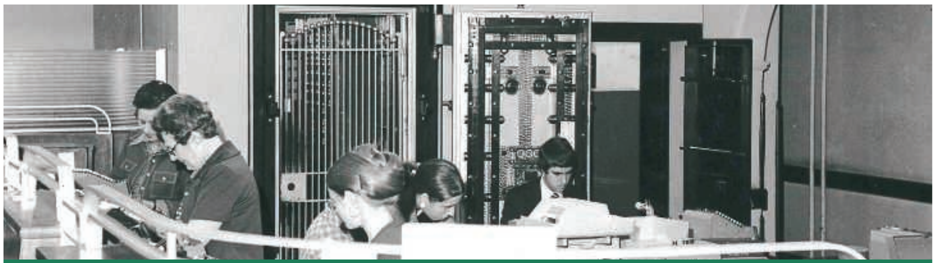
Karl J. "Jeff" Keller
Executive Vice President of Lending

# Financial Highlights

| 5 Year Summary | 2017 | 2016 | 2015 | 2014 | 2013 |
|---|---|---|---|---|---|
| **SUMMARY OF OPERATIONS** | | | | | |
| (in thousands) | | | | | |
| Interest Income | $ 9,637 | $ 8,997 | $ 8,485 | $ 8,245 | $ 8,724 |
| Interest Expense | 1,070 | 975 | 882 | 946 | 1,130 |
| Net Interest Income | 8,567 | 8,022 | 7,603 | 7,299 | 7,594 |
| Provision for Loan Losses | 133 | 40 | 15 | 420 | 660 |
| Other Income | 1,954 | 1,823 | 1,924 | 1,713 | 1,820 |
| Other Expense | 8,097 | 8,231 | 8,216 | 7,955 | 7,955 |
| Applicable Income Taxes | 861 | 229 | 190 | (76) | (19) |
| Net Income | $ 1,430 | $ 1,345 | $ 1,106 | $ 713 | $ 818 |
| **PER SHARE DATA** | | | | | |
| Net Income | $ 5.07 | $ 4.75 | $ 3.87 | $ 2.47 | $ 2.84 |
| Cash Dividends Declared | 1.15 | 1.00 | 0.90 | 0.90 | 1.10 |
| Book Value | 80.85 | 76.35 | 73.07 | 71.08 | 64.67 |
| **END OF YEAR BALANCE SHEET SUMMARY** | | | | | |
| (in thousands) | | | | | |
| Loans, Net | $ 173,681 | $ 154,225 | $ 137,160 | $ 130,523 | $ 125,031 |
| Securities Available for Sale | 95,515 | 107,472 | 102,153 | 98,718 | 121,837 |
| Securities Held for Maturity | 4,137 | 4,621 | 26,957 | 26,255 | 5,110 |
| Total Assets | 294,578 | 288,032 | 287,527 | 285,724 | 281,695 |
| Deposits | 267,760 | 255,514 | 260,777 | 261,706 | 261,586 |
| Capital | 22,821 | 21,550 | 20,770 | 20,144 | 18,651 |
| **SELECT RATIOS** | | | | | |
| Average Equity to Average Assets | 7.87% | 7.71% | 7.12% | 7.24% | 6.62% |
| Return on Average Assets | 0.50% | 0.47% | 0.39% | 0.25% | 0.28% |
| Return on Average Equity | 6.31% | 6.10% | 5.43% | 3.45% | 4.28% |





# DENNY BARRON

## 44 years and going strong

Denny Barron continues to make a difference after 44 years of service to JSB. He is now a member of our Jefferson Security Bank Board of Directors.

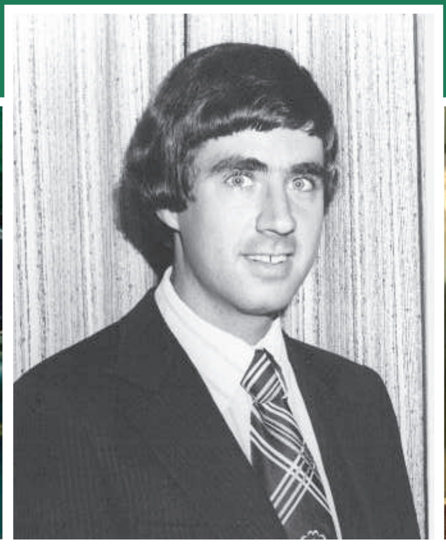
After Denny graduated from Shepherd College in 1973, he joined JSB and rose through the ranks of the organization while making a positive difference every step of the way. His influence on others and his dedication to the bank and the community is immeasurable.

Denny worked daily as a leader of our bank wearing many hats, fulfilling many positions and serving many customers. He will continue to be a pillar of strength of JSB. Denny's years of experience brought leadership, a wealth of knowledge, an understanding and appreciation for our heritage, customers, employees and our communities that greatly assisted in the JSB's decision-making efforts for the betterment of the bank, customers and markets where we live, work and play.

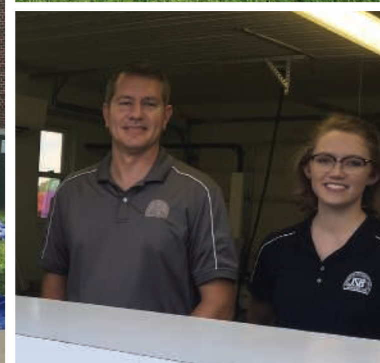
Denny is well-known for his work in 4-H, the Jefferson County Fair and Shepherdstown Fire Department. Barron's decades of volunteer work for the fire department includes coordinating and participating in countless fundraising events from weekly bingo games to the Fall Sportsman's Bash and Annual Apple Butter Festivals.

We are fortunate and honored to have Denny serve on our Board of Directors. He will continue his legacy in making a difference for Jefferson Security Bank.

Our most sincere and deepest appreciation to Denny for being such a huge part of our JSB team.







*Investing in our communities to help make a positive difference*


27th Annual
Shepherdstown Volunteer Fire Dept. / John D. Lowe, Jr.
Memorial Golf Classic

Yount Hyde & Barbour
Certified Public Accountants and Consultants

**Independent Auditor's Report**

To the Board of Directors and Shareholders
Jefferson Security Bank
Shepherdstown, West Virginia

**Report on the Financial Statements**
We have audited the accompanying consolidated financial statements of Jefferson Security Bank and its subsidiary, which comprise the consolidated balance sheets as of December 31, 2017 and 2016, the related consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, the financial statements).

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

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

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

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

**Opinion**
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Jefferson Security Bank and its subsidiary as of December 31, 2017 and 2016, 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.

Yount, Hyde & Barbour, P.C.

Winchester, Virginia
March 21, 2018

JEFFERSON SECURITY BANK AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
December 31, 2017 and 2016

| | 2017 | 2016 |
|---|---|---|
| **ASSETS** | | |
| Cash and due from financial institutions | $ 4,890,014 | $ 4,698,428 |
| Interest bearing deposits with depository institutions | 50,558 | 51,194 |
| Cash and cash equivalents | 4,940,572 | 4,749,622 |
| Securities available for sale, at fair value | 95,514,958 | 107,471,700 |
| Securities held to maturity (fair value of $4,207,399 - 2017; $4,692,110 - 2016) | 4,137,262 | 4,620,762 |
| Restricted securities, at cost | 396,100 | 706,900 |
| Loans, net of allowance for loan losses of $1,881,997 - 2017; $1,782,484 - 2016 | 173,681,235 | 154,225,062 |
| Accrued interest receivable | 866,488 | 932,242 |
| Premises and equipment, net | 6,074,478 | 6,373,239 |
| Bank owned life insurance | 6,053,355 | 5,890,202 |
| Other real estate owned, net of valuation allowances of $41,644 - 2016 | - - | 75,900 |
| Other assets | 2,913,576 | 2,986,138 |
| Total assets | $ 294,578,024 | $ 288,031,767 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| Liabilities | | |
| Deposits | | |
| Interest bearing | $ 199,465,070 | $ 191,029,907 |
| Noninterest bearing | 68,294,565 | 64,483,834 |
| Total deposits | 267,759,635 | 255,513,741 |
| Securities sold under an agreement to repurchase | 1,616,969 | 804,962 |
| Accrued interest payable | 27,372 | 42,997 |
| Federal Home Loan Bank advances | 637,600 | 8,712,700 |
| Other accrued expenses and other liabilities | 1,715,619 | 1,406,913 |
| Total liabilities | 271,757,195 | 266,481,313 |
| Shareholders' Equity | | |
| Common stock, $10 par value; 300,000 shares authorized; issued and outstanding, 282,246 shares at December 31, 2017 and 2016 | 2,822,460 | 2,822,460 |
| Additional paid-in capital | 2,822,460 | 2,822,460 |
| Retained earnings | 20,517,537 | 18,832,571 |
| Accumulated other comprehensive (loss), net | (3,341,628) | (2,927,037) |
| Total shareholders' equity | 22,820,829 | 21,550,454 |
| Total liabilities and shareholders' equity | $ 294,578,024 | $ 288,031,767 |

See accompanying notes to consolidated financial statements

JEFFERSON SECURITY BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
For the Years Ended December 31, 2017 and 2016

| | 2017 | 2016 |
|---|---|---|
| Interest and dividend income | | |
| Loans, including fees | $ 7,362,438 | $ 6,396,543 |
| Securities: | | |
| Taxable | 1,413,725 | 1,696,885 |
| Nontaxable | 820,335 | 870,554 |
| Dividends and other interest | 40,431 | 32,621 |
| Total interest and dividend income | 9,636,929 | 8,996,603 |
| Interest expense | | |
| Deposits | 1,033,001 | 952,534 |
| Borrowings | 37,132 | 22,066 |
| Total interest expense | 1,070,133 | 974,600 |
| **Net interest income** | 8,566,796 | 8,022,003 |
| Provision for loan losses | 133,000 | 40,000 |
| **Net interest income after provision for loan losses** | 8,433,796 | 7,982,003 |
| Noninterest income | | |
| Service charges on deposit accounts | 640,561 | 577,760 |
| Other service charges, commissions and fees | 880,487 | 882,432 |
| Realized gain on securities | 116,167 | 89,161 |
| Income from bank owned life insurance | 163,153 | 162,895 |
| Other | 153,615 | 111,239 |
| Total noninterest income | 1,953,983 | 1,823,487 |
| Noninterest expense | | |
| Salaries and employee benefits | 4,208,978 | 4,120,140 |
| Occupancy | 1,212,027 | 1,207,722 |
| Advertising and marketing | 144,071 | 172,674 |
| ATM and debit card fees | 347,327 | 376,815 |
| Data processing | 715,230 | 707,945 |
| Postage and stationery supplies | 189,722 | 193,746 |
| Professional services | 337,296 | 290,522 |
| FDIC and state assessments | 165,905 | 213,190 |
| Other real estate owned expense, net | 16,113 | 189,857 |
| Director fees | 108,900 | 92,000 |
| Realized loss on fixed assets | 2,681 | 43,290 |
| Other | 648,368 | 623,522 |
| Total noninterest expense | 8,096,618 | 8,231,423 |
| **Income before income tax expense** | 2,291,161 | 1,574,067 |
| Income tax expense | 860,828 | 229,010 |
| **Net income** | $ 1,430,333 | $ 1,345,057 |
| **Basic and diluted earnings per common share** | $ 5.07 | $ 4.75 |

See accompanying notes to consolidated financial statements

JEFFERSON SECURITY BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS COMPREHENSIVE INCOME
For the Years Ended December 31, 2017 and 2016

| | 2017 | 2016 |
|---|---|---|
| Net income | $ 1,430,333 | $ 1,345,057 |
| Other comprehensive income (loss), net of tax: | | |
| Unrealized holding gains (losses) on securities available for sale arising during period | 67,990 | (974,102) |
| Reclassification adjustment for gains included in net income | (72,023) | (55,280) |
| Amortization of unrealized holding losses on securities transferred to held to maturity | - - | 44,274 |
| Reversal of unrealized holding losses on securities transferred to held to maturity | - - | 1,144,268 |
| Change in pension benefits | 123,916 | (292,584) |
| Reclassification adjustment for change in pension benefits included in net income | 51,709 | 49,100 |
| Change in supplemental executive retirement benefits | (34,547) | (94,716) |
| Reclassification adjustment for change in supplemental executive retirement benefits included in net income | 27,580 | 23,815 |
| Total other comprehensive income (loss) | 164,625 | (155,225) |
| Comprehensive income | $ 1,594,958 | $ 1,189,832 |

See accompanying notes to consolidated financial statements

JEFFERSON SECURITY BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
For the Years Ended December 31, 2017 and 2016

| | Common Stock | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive (Loss) | Total Shareholders' Equity |
|---|---|---|---|---|---|
| **Balance at December 31, 2015** | $ 2,842,460 | $ 2,842,460 | $ 17,856,760 | $ (2,771,812) | $ 20,769,868 |
| Net income | - - | - - | 1,345,057 | - - | 1,345,057 |
| Other comprehensive loss | - - | - - | - - | (155,225) | (155,225) |
| Repurchase of common stock | (20,000) | (20,000) | (86,000) | - - | (126,000) |
| Cash dividends - $1.00 per share | - - | - - | (283,246) | - - | (283,246) |
| **Balance at December 31, 2016** | $ 2,822,460 | $ 2,822,460 | $ 18,832,571 | $ (2,927,037) | $ 21,550,454 |
| Net income | - - | - - | 1,430,333 | - - | 1,430,333 |
| Other comprehensive income | - - | - - | - - | 164,625 | 164,625 |
| Reclassification of stranded tax effects from change in tax rate | - - | - - | 579,216 | (579,216) | - - |
| Cash dividends - $1.15 per share | - - | - - | (324,583) | - - | (324,583) |
| **Balance at December 31, 2017** | $ 2,822,460 | $ 2,822,460 | $ 20,517,537 | $ (3,341,628) | $ 22,820,829 |

See accompanying notes to consolidated financial statements

JEFFERSON SECURITY BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2017 and 2016

| | 2017 | 2016 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Net income | $ 1,430,333 | $ 1,345,057 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 556,068 | 537,079 |
| Provision for loan losses | 133,000 | 40,000 |
| Provision for other real estate owned | 13,500 | 175,569 |
| Deferred income tax expense (benefit) | 7,807 | (11,860) |
| Deferred income tax expense from change in federal tax rate | 385,241 | - - |
| Net amortization of securities | 668,901 | 736,489 |
| Net gain on sale of securities available for sale | (111,172) | (51,157) |
| Net gain on call of securities available for sale | (4,995) | (38,004) |
| Net loss (gain) on sale of other real estate owned | 3,513 | (10,212) |
| Deferred gains recognized on other real estate owned | (1,225) | (4,121) |
| Net loss on fixed assets | 2,681 | 43,290 |
| Income from bank owned life insurance | (163,153) | (162,895) |
| Net change in: | | |
| Accrued interest receivable | 65,754 | 25,847 |
| Accrued interest payable | (15,625) | (10,327) |
| Other assets | (318,013) | 162,912 |
| Other accrued expenses and other liabilities | 477,364 | (294,059) |
| Net cash provided by operating activities | 3,129,979 | 2,483,608 |
| **Cash flows from investing activities** | | |
| Net increase in loans | (19,589,173) | (17,294,282) |
| Purchase of securities available for sale | (20,114,302) | (27,270,590) |
| Proceeds from sale of securities available for sale | 15,378,874 | 3,963,580 |
| Proceeds from calls, maturities and principal paydowns of securities available for sale | 16,137,239 | 15,641,594 |
| Proceeds from calls, maturities and principal paydowns of securities held to maturity | 479,191 | 24,292,459 |
| Proceeds from the sale of other real estate owned | 60,112 | 796,831 |
| Net decrease (increase) in Federal Home Loan Bank stock | 310,800 | (205,000) |
| Premises and equipment expenditures, net | (259,988) | (404,828) |
| Net cash used in investing activities | (7,597,247) | (480,236) |
| **Cash flows from financing activities** | | |
| Net increase (decrease) in interest bearing deposits | 8,435,163 | (9,395,698) |
| Net increase in noninterest bearing deposits | 3,810,731 | 4,132,849 |
| Net increase (decrease) in securities sold under an agreement to repurchase | 812,007 | (336,463) |
| Net decrease in federal funds purchased | - - | (102,000) |
| Net (decrease) increase in Federal Home Loan Bank advances | (8,075,100) | 5,415,700 |
| Repurchase of common stock | - - | (126,000) |
| Dividends paid | (324,583) | (283,246) |
| Net cash provided by (used in) financing activities | 4,658,218 | (694,858) |
| Net change in cash and cash equivalents | 190,950 | 1,308,514 |
| Cash and cash equivalents at beginning of year | 4,749,622 | 3,441,108 |
| **Cash and cash equivalents at end of year** | $ 4,940,572 | $ 4,749,622 |

See accompanying notes to consolidated financial statements

JEFFERSON SECURITY BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2017 and 2016
(Continued)

| | 2017 | 2016 |
|---|---|---|
| Supplemental disclosures: | | |
| Interest paid | $ 1,085,758 | $ 984,927 |
| Income taxes paid | 439,658 | 93,075 |
| Transfers from loans to other real estate owned | - - | 189,000 |
| Change in unrealized holding (losses) gains on available for sale securities | (6,506) | (1,660,294) |
| Amortization of unrealized holding losses on securities transferred from available for sale to held to maturity | - - | 71,409 |
| Reversal of unrealized holding losses on securities transferred from available for sale to held to maturity | - - | 1,845,594 |
| Change in pension benefits | 283,267 | (392,716) |
| Change in supplemental executive retirement benefits | (11,238) | (114,355) |

See accompanying notes to consolidated financial statements

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The accounting and reporting policies of Jefferson Security Bank and Subsidiary conform to accounting principles generally accepted in the United States of America and to general practice within the banking industry. The following describes the significant accounting and reporting policies which are employed in the preparation of the consolidated financial statements.

Basis of Presentation: The consolidated financial statements include the accounts of Jefferson Security Bank and its wholly-owned limited liability company, JSB Financial, LLC. JSB Financial, LLC is an inactive subsidiary previously used for offering financial services therefore, no elimination entries were needed for consolidation.

Nature of Operations, Business Segments: Jefferson Security Bank is headquartered in Shepherdstown, West Virginia. The principal markets for the Bank's financial services are the eastern panhandle region of West Virginia in Jefferson and Berkeley Counties and in adjacent Washington County, Maryland including the areas immediately surrounding these communities.

The Bank provides a full range of banking services to individuals, agricultural businesses, commercial businesses, local government entities and non-profit organizations through its main office and five full-service retail banking offices and one drive-thru banking office located throughout its market area. It maintains a diversified loan portfolio, including loans to individuals for home mortgages, automobiles and personal expenditures, and loans to business enterprises for current operations and expansion.

The Bank offers a variety of deposit products, including checking, savings, money market, individual retirement accounts and certificates of deposit. While the Bank’s management monitors the revenue stream of various products and services, operations are managed and financial performance is evaluated on a Bank wide basis. Accordingly, all of the Bank’s operations are considered by management to be aggregated into one operating segment.

Use of Estimates: To prepare financial statements in conformity with accounting principles generally accepted in the United States of America, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the consolidated financial statements and the disclosures provided, and future results could differ. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of other real estate owned, valuation of deferred tax assets, other than temporary impairment of securities and the determination of the pension and supplemental executive retirement plan benefits and obligations.

Cash and Cash Equivalents: For purposes of the consolidated balance sheets and the consolidated statements of cash flows, cash and cash equivalents includes cash on hand, cash items, amounts due from financial institutions with original maturities less than 90 days, interest bearing deposits with depository institutions with maturities within 90 days and federal funds sold. Amounts due from financial institutions may, at times, exceed federally insured limits and are carried at cost.

Securities: Certain debt securities that management has the positive intent and ability to hold to maturity are classified as “held to maturity,” which are accounted for at cost and adjusted for amortization of premiums and accretion of discounts. Trading securities are recorded at fair value with changes in fair value included in earnings. Securities not classified as held to maturity or trading, including debt and equity securities with readily determinable fair values, are classified as “available for sale” and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method. Other restricted securities are carried at cost. All investments are classified as either held to maturity or available for sale, except for stock in Federal Home Loan Bank and Community Bankers Bank, which are classified as restricted securities.

The Bank follows relevant accounting guidance related to recognition and presentation of other than temporary impairment. This accounting guidance specifies that (*a*) if a company does not have the intent to sell the debt security prior to recovery and (*b*) it is more likely than not that it will not have to sell the debt security prior to recovery, the security would not be considered other than temporarily impaired unless there is a credit loss. When the Bank does not intend to sell the security, and it is more likely than not the Bank will not have to sell the security before recovery of its cost basis, it will recognize the credit component of an other than temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income.

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

For equity securities, when the Bank has decided to sell an impaired available for sale security and the Bank does not expect the fair value of the security to fully recover before the expected time of sale, the security is deemed other than temporarily impaired in the period in which the decision to sell is made and the entire amount of the impairment is recognized through earnings. The Bank recognizes an impairment loss when the impairment is deemed other than temporary even if a decision to sell has not been made.

Federal Home Loan Bank Stock: The Bank, as a member of the Federal Home Loan Bank (FHLB) of Pittsburgh, is required to maintain an investment in capital stock of the FHLB. Based on redemption provisions of the FHLB, the stock has no quoted market value and is carried at cost. The redemption of FHLB stock is subject to certain limitations and conditions. At its discretion, the FHLB may declare dividends on the stock. Management reviews for impairment based on the ultimate recoverability of the cost basis in the FHLB stock.

Loans: Loans that management has the intent and ability to hold for the foreseeable future or until payoff or maturity are reported at the principal balance outstanding less the allowance for loan losses and any deferred fees or costs. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using either the interest method or straight-line method.

Interest income is reported on the interest method and includes amortization of net deferred loan fees and costs over the estimated loan term. Interest income is not recorded when full loan repayment is in doubt, typically when the loan is impaired or payments are past due over 90 days, unless the loan is both well secured and in the process of collection. All interest accrued but not collected for loans that are placed on nonaccrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

When a loan is not fully collateralized and is in the process of collection, the Bank may charge off the account balance or some portion thereof as a loss. Generally, a delinquency over 120 days past due will be charged off unless the loan is well secured and an acceptable collection plan is in place with the exception of personal residential property which may be charged off at 150 days.

All charge offs are approved by the Loan Committee and reported to the Board of Directors.

Risk characteristics associated with specific segments of the loan portfolio are detailed below:

Commercial loans not secured by real estate carry risks associated with the successful operation of a business, and the repayments of these loans depend on the profitability and cash flows of the business. Borrowers may be subject to changes in industry conditions including decreasing demand and increasing material and production costs that cannot be immediately recaptured. Interest rate increases could have an adverse impact on the profitability of the business. Additional risk relates to the value of collateral where depreciation occurs and the valuation is less precise.

Commercial loans secured by real estate carry risks associated with the profitability of the business and the ability to generate positive cash flows sufficient to service debts. Real estate security diminishes risks only to the extent that a market exists for the collateral. Real estate secured construction loans carry risks that a project will not be completed as scheduled and budgeted and that the value of the collateral may, at any point, be less than the principal amount of the loan. Additional risks may occur if the general contractor, who may not be a loan customer, is unable to finish the project as planned due to financial pressures unrelated to the project.

Residential real estate loans carry risks associated with the continued credit worthiness of the borrower and changes in the value of collateral. These loans are subject to adverse employment conditions in the local economy leading to an increase in default rates. Residential real estate loans are mainly comprised of adjustable rate mortgages. In the event of incremental rate increases, the borrowers' ability to maintain payments may be impacted.

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

Consumer loans carry risks associated with the continued credit worthiness of the borrower and the value of the underlying collateral. In addition, these loans may be unsecured. Consumer loans are more likely to be immediately affected adversely by unemployment, divorce, illness or personal bankruptcy. Consumer loans are further segmented into credit cards and all other consumer loans.

Allowance for Loan Losses: The allowance for loan losses is an estimate of probable losses inherent in the loan portfolio. The allowance for loan losses is increased by the provision for loan losses and decreased by charged off loans less recoveries. Management's evaluation of the adequacy of the allowance for loan losses is based on a quarterly evaluation of the loan portfolio. Management estimates the allowance balance required using historical experience, the nature and volume of the portfolio, information about specific borrower situations, estimated collateral values, economic conditions and other factors. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that in management's judgment, should be charged off. Loan losses are charged against the allowance when management believes the loan to be uncollectible. Subsequent recoveries, if any, are credited to the allowance for loan losses.

The allowance consists of specific and general components. The specific component relates to loans that are classified as impaired. A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal and 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 history, and the amount of the shortfall in relation to the principal and interest owed. The recorded investment in impaired loans is defined as the unpaid principal balance less any partial charge offs and/or net of any interest payments made by the borrower during the nonaccrual period.

For purposes of computing the specific loss component of the allowance, impairment is evaluated in total for smaller-balance loans of similar nature such as consumer loans using historical experience and on an individual loan basis for other loans. For impaired loans individually evaluated, specific allocations are based on the present value of expected future cash flows from the loan discounted at the loan's original effective rate or the fair value of collateral less estimated costs to sell if the loan is collateral dependent.

The general component covers non-classified loans and is based on historical loss experience adjusted for nine qualitative factors. The historical loss experience is calculated based on losses in the portfolio over the previous five years. For the qualitative factors, the first factor is comprised of delinquent loans, accruing watchlist, nonaccrual loans and net charge offs. The factor is applied to each loan segment. The second factor involves economic and industry conditions. Economic and industry conditions are assessed as well as their impact on collateral value to arrive at assigned factor values, which are then applied to the loan segment balances. The other seven factors are based on economic conditions, lending policy and procedures, the experience of the loan department, quality of loan review, the composition of the loan portfolio, concentrations of credit and external factors such as competition, legal issues and regulatory requirements. These factors are subjective and the Bank's management provides input on these factors to determine the factor value to be equally applied to each loan segment.

Troubled Debt Restructurings: In situations where, for economic or legal reasons related to a borrower's financial condition, management may grant a concession to the borrower that it would not otherwise consider, the related loan is classified as a troubled debt restructuring (TDR). Management strives to identify borrowers in financial difficulty early and work with them to modify their loan to more affordable terms before their loan reaches nonaccrual status. These modified terms may include rate reductions, principal forgiveness, payment forbearance and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. In cases where borrowers are granted new terms that provide for a reduction of either interest or principal, management measures any impairment on the restructuring as noted previously for impaired loans. TDRs are individually evaluated for impairment.

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

Other Real Estate Owned: Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value, less estimated selling costs, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in noninterest expense.

Concentrations of Credit Risk: Most of the Bank's activities are with customers located within Berkeley and Jefferson counties of West Virginia and in areas of Washington County, Maryland. Note 4, Notes to Consolidated Financial Statements, details the types of lending in which the Bank engages. The Bank does not have any significant concentrations in any one industry or customer.

Premises and Equipment: Land is carried at cost. Premises and equipment are stated at cost, less accumulated depreciation. Depreciation is computed using the straight-line method with useful lives ranging from 5 to 40 years for buildings and improvements, and 3 to 35 years for furniture and equipment. Maintenance, repairs and minor alterations are charged to current operations as expenditures are incurred. Major improvements are capitalized.

Employee Benefits: As of December 31, 2013, the Bank froze the defined benefit pension plan. A benefit plan with 401(k) features is available to employees age 21 and over who have worked at least one year with 1,000 hours of service. The plan allows employee contributions, with matching contributions, to be allocated based on a percentage of the employee salary deferral. The Bank contributed a percentage of each eligible employees' salary to their 401(k) plan account during 2017 and intends to continue this practice. The Bank provides a supplemental executive retirement plan to members of senior management who had not obtained their maximum benefit under the defined benefit pension plan.

Income Taxes: When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheets along with any associated interest and penalties that would be payable to the taxing authorities upon examination. Interest and penalties associated with unrecognized tax benefits, if any, are classified as additional income taxes in the consolidated statements of income. As of December 31, 2017 and 2016, there was no liability for unrecognized tax benefits.

Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws.

Comprehensive Income: Comprehensive income consists of net income and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized holding gains and losses on securities available for sale, unrealized holding losses on securities transferred from available for sale to held to maturity and pension and postretirement benefits.

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

Bank Owned Life Insurance: The Bank has purchased life insurance policies on certain key employees. Bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value.

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

Stock Repurchase Plan: In May 2016, the Federal Deposit Insurance Corporation (FDIC) approved the open market repurchase of up to 15,000 shares of the issued and outstanding shares of Jefferson Security Bank's common stock. There were no shares purchased either as part of a publicly announced plan or otherwise. In June 2017, the FDIC approved the repurchase of up to 15,000 shares under similar terms. The approval will expire in 12 months unless a request for an extension is approved. The timing and quantity of purchases under this stock repurchase program will be at the discretion of the Board of Directors, and the program may be discontinued, or suspended and reinitiated, at any time. Under this approval, there were no additional purchases of the Bank's common stock, either as part of a publicly announced plan or otherwise.

Dividend Restriction: Bank regulatory agencies restrict, without prior approval, the total dividend payments of a bank in any calendar year to the bank's retained net income of that year to date, as defined, combined with its retained net income of the preceding two years, less any required transfers to surplus. At December 31, 2017, retained net income, which was free of such restriction, amounted to approximately $3,016,474.

Reclassifications: Some items in the prior year financial statements were reclassified to conform to the current presentation. Such reclassifications had no material effect on the financial position and results of operations.

Financial Instruments with Off-Balance Sheet Risk: Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and standby letters of credit issued to meet customer needs. The face amount for these items represents the exposure to loss before considering customer collateral or repayment ability. Such financial instruments are recorded when they are funded.

Advertising Costs: The Bank follows the policy of charging the costs of advertising to expense as incurred. Total advertising expense incurred for 2017 and 2016 was $23,475 and $36,187, respectively.

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 Bank – put presumptively beyond reach of the transferor and its creditors, even in bankruptcy or other receivership, (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 Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets.

**Recent Accounting Pronouncements**

Adoption of New Accounting Standards

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers: Topic 606." This ASU revised guidance for the recognition, measurement, and disclosure of revenue from contracts with customers. The original guidance has been amended through subsequent accounting standard updates that resulted in technical corrections, improvements, and a one-year deferral of the effective date to January 1, 2018. The guidance, as amended, is applicable to all entities and, once effective, will replace significant portions of existing industry and transaction-specific revenue recognition rules with a more principles-based recognition model. Most revenue associated with financial instruments, including interest income, loan origination fees, and credit card fees, is outside the scope of the guidance. Gains and losses on investment securities, derivatives, and sales of financial instruments are similarly excluded from the scope. Entities can elect to adopt the guidance either on a full or modified retrospective basis. Full retrospective adoption will require a cumulative effect adjustment to retained earnings as of the beginning of the earliest comparative period presented. Modified retrospective adoption will require a cumulative effect adjustment to retained earnings as of the beginning of the reporting period in which the entity first applies the new guidance. The Bank plans to adopt this guidance on the effective date, January 1, 2018 via the modified retrospective approach. The Bank has completed its assessment of the adoption of this

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

ASU, noting the standard will result in expanded disclosures related to non-interest income and enhance the qualitative disclosures on the revenues within the scope of the new guidance. The Bank has concluded the adoption of ASU 2014-09 will not have a material impact on its consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, "Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities." The amendments in ASU 2016-01, among other things: 1) Requires equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. 2) Requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. 3) Requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables). 4) Eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost. The amendments in this ASU are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Bank does not expect the adoption of ASU 2016-01 to have a material impact on its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)." Among other things, in the amendments in ASU 2016-02, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) A lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) A right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted upon issuance. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The Bank does not expect the adoption of ASU 2016-02 to have a material impact on its consolidated financial statements. The Bank does not have lease agreements for premises and equipment that meet the standard definition of a financing lease. The Bank is the lessor of three properties, which will be treated as short-term operating leases.

During June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." The amendments in this ASU, among other things, require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. For public companies that are not SEC filers, the amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020. The Bank is currently assessing the impact that ASU 2016-13 will have on its consolidated financial statements. The Bank has formed a working group to address information requirements, determine methodology, research forecasts and ensure readiness and compliance with the standard. The Bank has an existing model provider for the CECL model and the Bank will run multiple concurrent models prior to the effective date.

During August 2016, the FASB issued ASU No. 2016-15, "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments", to address diversity in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The amendments are effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The amendments should be applied using a retrospective transition method to each period presented. If retrospective application is impractical for some of the issues addressed by the update, the amendments for those issues would be applied prospectively as of the earliest date practicable. Early adoption is permitted, including adoption in an interim period. The Bank does not expect the adoption of ASU 2016-15 to have a material impact on its consolidated financial statements.

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

During March 2017, the FASB issued ASU 2017-07, "Compensation — Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost." The amendments in this ASU require an employer that offers defined benefit pension plans, other postretirement benefit plans, or other types of benefits accounted for under Topic 715 to report the service cost component of net periodic benefit cost in the same line item(s) as other compensation costs arising from services rendered during the period. The other components of net periodic benefit cost are required to be presented in the income statement separately from the service cost component. If the other components of net periodic benefit cost are not presented on a separate line or lines, the line item(s) used in the income statement must be disclosed. In addition, only the service cost component will be eligible for capitalization as part of an asset, when applicable. The amendments are effective for annual periods beginning after December 15, 2017, including interim periods within those annual periods. Early adoption is permitted. The Bank does not expect the adoption of ASU 2017-07 to have a material impact on its consolidated financial statements.

During March 2017, the FASB issued ASU 2017-08, "Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20), Premium Amortization on Purchased Callable Debt Securities." The amendments in this ASU shorten the amortization period for certain callable debt securities purchased at a premium. Upon adoption of the standard, premiums on these qualifying callable debt securities will be amortized to the earliest call date. Discounts on purchased debt securities will continue to be accreted to maturity. The amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. Upon transition, entities should apply the guidance on a modified retrospective basis, with a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption and provide the disclosures required for a change in accounting principle. The Bank is currently assessing the impact that ASU 2017-08 will have on its consolidated financial statements.

During February 2018, the FASB issued ASU 2018-02, "Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income." The amendments provide financial statement preparers with an option to reclassify stranded tax effects within accumulated other comprehensive income to retained earnings in each period in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act (or portion thereof) is recorded. The amendments are effective for all organizations for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. Organizations should apply the proposed amendments either in the period of adoption or retrospectively to each period (or periods) in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act is recognized. The Bank has elected to reclassify the stranded income tax effects from the Tax Cuts and Jobs Act in the consolidated financial statements for the period ending December 31, 2017. The amount of this reclassification in 2017 was $579,216.

**NOTE 2 – EARNINGS PER SHARE**

Basic and diluted earnings per common share are calculated by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share include the dilutive effects of additional potential common shares, if present. No such items exist as of December 31, 2017 and 2016. Therefore, diluted earnings per share equals basic earnings per share for both years. Basic and diluted earnings per share are calculated based on weighted average common shares outstanding of 282,246 for December 31, 2017 and 282,900 for December 31, 2016. Basic and diluted earnings per common share was $5.07 and $4.75 for the years ended December 31, 2017 and 2016, respectively.

**NOTE 3 – SECURITIES**

The primary purposes of the securities portfolio are to generate income, supply collateral for public funds on deposit and meet liquidity needs of the Bank through readily saleable financial instruments. The portfolio is made up of fixed rate bonds, whose prices move inversely with interest rates, as well as variable rate bonds, whose prices correspond directly with interest rates. At the end of any accounting period, the securities portfolio may have both unrealized gains and losses. The Bank monitors the portfolio which is subject to liquidity needs, market rate changes and credit risk changes to determine if adjustments are needed.

**NOTE 3 – SECURITIES (Continued)**

The amortized cost and fair value of securities, with unrealized gains and losses, for the available for sale portfolio is shown in the following table.

| Available for Sale | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| **December 31, 2017** | | | | |
| U.S. Government and agency | $ 70,964,606 | $ 201,863 | $ (964,228) | $ 70,202,241 |
| State and municipal | 25,424,740 | 142,118 | (254,141) | 25,312,717 |
| | $ 96,389,346 | $ 343,981 | $ (1,218,369) | $ 95,514,958 |
| **December 31, 2016** | | | | |
| U.S. Government and agency | $ 70,435,849 | $ 414,878 | $ (929,187) | $ 69,921,540 |
| State and municipal | 37,903,733 | 215,381 | (568,954) | 37,550,160 |
| | $ 108,339,582 | $ 630,259 | $ (1,498,141) | $ 107,471,700 |

The amortized cost and fair value of securities, with unrealized gains and losses, for the held to maturity portfolio is shown in the following table.

| Held to Maturity | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| **December 31, 2017** | | | | |
| U.S. Government and agency | $ 1,591,668 | $ 2,718 | $ (5,385) | $ 1,589,001 |
| State and municipal | 2,545,594 | 72,804 | - - | 2,618,398 |
| | $ 4,137,262 | $ 75,522 | $ (5,385) | $ 4,207,399 |
| **December 31, 2016** | | | | |
| U.S. Government and agency | $ 2,061,217 | $ 23,962 | $ (1,073) | $ 2,084,106 |
| State and municipal | 2,559,545 | 59,591 | (11,132) | 2,608,004 |
| | $ 4,620,762 | $ 83,553 | $ (12,205) | $ 4,692,110 |

At December 31, 2017 and 2016, securities were pledged to secure public deposits and for other purposes required or permitted by law. These securities had a fair value of $70,638,494 and $69,295,768, and an amortized cost of $71,166,447 and $69,246,878, at December 31, 2017 and 2016, respectively. The fair value of securities pledged to secure securities sold under an agreement to repurchase was $1,850,638 and $1,981,180, and the amortized cost of these securities was $1,846,353 and $1,960,634 at December 31, 2017 and 2016, respectively.

The amortized cost and fair value of debt securities by contractual maturity at December 31, 2017 follows:

| | Available for Sale | | Held to Maturity | |
|---|---|---|---|---|
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| Due in less than one year | $ - - | $ - - | $ - - | $ - - |
| Due from one to five years | 4,982,554 | 4,934,197 | - - | - - |
| Due from five to ten years | 32,908,013 | 32,677,287 | 533,920 | 541,882 |
| Due after ten years | 58,498,779 | 57,903,474 | 3,603,342 | 3,665,517 |
| | $ 96,389,346 | $ 95,514,958 | $ 4,137,262 | $ 4,207,399 |

**NOTE 3 – SECURITIES (Continued)**

For the years ended December 31, 2017 and 2016, proceeds from sales and calls of securities available for sale were $19,118,874 and $6,393,580, respectively. Gross realized gains on sales and calls on available for sale securities amounted to $183,840 and $58,757, while gross realized losses amounted to $67,673 and $7,600 for the years ended December 31, 2017 and 2016, respectively. The tax provision applicable to these net realized gains were $44,144 and $19,440 in 2017 and 2016, respectively.

For the years ended December 31 2017 and 2016, there were no proceeds from the sales of securities held to maturity. For the year ended December 31, 2017, there were no proceeds for the calls of securities held to maturity and no gross gains or gross losses realized. During 2016, proceeds from the calls of securities held to maturity were $23,700,000. Gross realized gains on the calls of held to maturity securities amounted to $38,004 with no gross realized losses for the year ended December 31, 2016. The tax provision applicable to the net realized gains amounted to $14,441 in 2016.

An impairment is considered "other than temporary" if any of the following conditions are met: the Bank intends to sell the security, it is more likely than not that the Bank will be required to sell the security before the recovery of its cost basis, or the Bank does not expect to recover the security's entire cost basis, even if the Bank does not intend to sell. On at least a quarterly basis, the Bank reviews available for sale and held to maturity securities for other than temporary impairment based on the severity and duration to which the cost basis exceeds the market value, changes related to credit quality factors of the issuer including economic and financial conditions, the present value of cash flows expected to be collected on the securities and the Bank's ability and intent to hold the security until maturity.

The Bank does not have any securities that are considered "other than temporarily impaired" at December 31, 2017 and 2016. Based on market prices at the respective dates, the Bank had seventy-eight securities at December 31, 2017 and one hundred securities at December 31, 2016 with unrealized losses, including unrealized holding losses. These unrealized losses were caused by interest rate fluctuations and not due to credit deterioration of the issuers. The following tables detail securities with unrealized losses, including those with unrealized holding losses at December 31, 2017 and 2016.

| | Duration of Unrealized Losses at December 31, 2017 | | | | | |
|---|---|---|---|---|---|---|
| | Less than 12 months | | 12 months or longer | | Total | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| U.S. Government and agency | $ 23,831,266 | $ (202,809) | $ 28,556,467 | $ (766,804) | $ 52,387,733 | $ (969,613) |
| State and municipal | 3,558,375 | (36,333) | 6,299,733 | (217,808) | 9,858,108 | (254,141) |
| | $ 27,389,641 | $ (239,142) | $ 34,856,200 | $ (984,612) | $ 62,245,841 | $ (1,223,754) |

| | Duration of Unrealized Losses at December 31, 2016 | | | | | |
|---|---|---|---|---|---|---|
| | Less than 12 months | | 12 months or longer | | Total | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| U.S. Government and agency | $ 49,811,740 | $ (929,985) | $ 106,372 | $ (275) | $ 49,918,112 | $ (930,260) |
| State and municipal | 21,096,538 | (580,086) | - - | - - | 21,096,538 | (580,086) |
| | $ 70,908,278 | $ (1,510,071) | $ 106,372 | $ (275) | $ 71,014,650 | $ (1,510,346) |

## NOTE 4 – LOANS

Loans are shown on the consolidated balance sheets net of the allowance for loan losses. Interest is computed by methods that result in level rates of return on principal. Loans are charged off when, in the opinion of management, they are deemed to be uncollectible after taking into consideration such factors as the current financial condition of the customer and the underlying collateral and guarantees.

The following table presents a summary of the balances of loans at December 31, 2017 and 2016.

| | December 31, 2017 | December 31, 2016 |
|---|---|---|
| Loans secured by real estate: | | |
| Commercial real estate: | | |
| Construction | $ 9,925,943 | $ 11,020,577 |
| Owner occupied | 16,440,764 | 18,480,006 |
| Non-owner occupied | 23,023,338 | 20,473,097 |
| Residential real estate: | | |
| Construction | 7,512,518 | 4,082,253 |
| Home equity | 13,758,413 | 13,742,873 |
| Other | 95,868,559 | 83,593,002 |
| Total loans secured by real estate | 166,529,535 | 151,391,808 |
| Commercial | 6,316,833 | 1,856,816 |
| Consumer: | | |
| Credit cards | 321,678 | 246,078 |
| Revolving credit plans | 178,351 | 153,538 |
| Other | 2,657,494 | 2,629,755 |
| | 176,003,891 | 156,277,995 |
| Net deferred loan fees and costs | (440,659) | (270,449) |
| Allowance for loan losses | (1,881,997) | (1,782,484) |
| Loans, net | $ 173,681,235 | $ 154,225,062 |

## NOTE 5 – ALLOWANCE FOR LOAN LOSSES

Management's evaluation of the adequacy of the allowance for loan losses is based on many factors including historical experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, and current economic conditions.

An analysis of the allowance for loan losses follows for the years ended December 31, 2017 and 2016:

| | 2017 | 2016 |
|---|---|---|
| Beginning balance | $ 1,782,484 | $ 1,710,142 |
| Loans charged off | (273,259) | (86,146) |
| Recoveries | 239,772 | 118,488 |
| Provision for loan losses | 133,000 | 40,000 |
| Ending balance | $ 1,881,997 | $ 1,782,484 |

**NOTE 5 – ALLOWANCE FOR LOAN LOSSES (Continued)**

| | Commercial Real Estate | Residential Real Estate | Commercial | Consumer | Total |
|---|---|---|---|---|---|
| **December 31, 2017** | | | | | |
| **Allowance for loan losses:** | | | | | |
| Beginning balance | $ 566,125 | $ 1,164,851 | $ 18,434 | $ 33,074 | $ 1,782,484 |
| Loans charged off | (239,564) | (27,061) | - - | (6,634) | (273,259) |
| Recoveries | 178,338 | 2,502 | 54,051 | 4,881 | 239,772 |
| Provision for loan losses | 78,657 | 70,339 | (15,225) | (771) | 133,000 |
| Ending balance | $ 583,556 | $ 1,210,631 | $ 57,260 | $ 30,550 | $ 1,881,997 |
| Ending balance: individually evaluated for impairment | $ 136,000 | $ 149,000 | $ - - | $ 2,000 | $ 287,000 |
| Ending balance: collectively evaluated for impairment | $ 447,556 | $ 1,061,631 | $ 57,260 | $ 28,550 | $ 1,594,997 |
| **Loans:** | | | | | |
| Ending balance | $ 49,390,045 | $ 117,139,490 | $ 6,316,833 | $ 3,157,523 | $ 176,003,891 |
| Ending balance: individually evaluated for impairment | $ 5,816,964 | $ 1,018,857 | $ - - | $ 18,219 | $ 6,854,040 |
| Ending balance: collectively evaluated for impairment | $ 43,573,081 | $ 116,120,633 | $ 6,316,833 | $ 3,139,304 | $ 169,149,851 |

| | Commercial Real Estate | Residential Real Estate | Commercial | Consumer | Total |
|---|---|---|---|---|---|
| **December 31, 2016** | | | | | |
| **Allowance for loan losses:** | | | | | |
| Beginning balance | $ 558,346 | $ 1,096,346 | $ 24,253 | $ 31,197 | $ 1,710,142 |
| Loans charged off | (12,223) | (63,948) | - - | (9,975) | (86,146) |
| Recoveries | 87,814 | 29,145 | - - | 1,529 | 118,488 |
| Provision for loan losses | (67,812) | 103,308 | (5,819) | 10,323 | 40,000 |
| Ending balance | $ 566,125 | $ 1,164,851 | $ 18,434 | $ 33,074 | $ 1,782,484 |
| Ending balance: individually evaluated for impairment | $ 70,000 | $ 158,000 | $ - - | $ 3,000 | $ 231,000 |
| Ending balance: collectively evaluated for impairment | $ 496,125 | $ 1,006,851 | $ 18,434 | $ 30,074 | $ 1,551,484 |
| **Loans:** | | | | | |
| Ending balance | $ 49,973,680 | $ 101,418,128 | $ 1,856,816 | $ 3,029,371 | $ 156,277,995 |
| Ending balance: individually evaluated for impairment | $ 6,058,831 | $ 922,964 | $ - - | $ 21,735 | $ 7,003,530 |
| Ending balance: collectively evaluated for impairment | $ 43,914,849 | $ 100,495,164 | $ 1,856,816 | $ 3,007,636 | $ 149,274,465 |

**NOTE 5 – ALLOWANCE FOR LOAN LOSSES (Continued)**

For the impaired loans represented in the tables below, the recorded investment amounts represent the outstanding principal balance on each loan represented. The unpaid principal balance represents the outstanding principal balance plus any amount that has been charged off and/or any payments that have been applied towards principal on nonaccrual loans.

Impaired loans at December 31, 2017 were as follows:

| December 31, 2017 | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
|---|---|---|---|---|---|
| **With no related allowance recorded:** | | | | | |
| Commercial real estate: | | | | | |
| Construction | $ 563,350 | $ 563,350 | $ - - | $ 575,074 | $ 32,165 |
| Owner occupied | 227,834 | 227,834 | - - | 227,834 | 14,145 |
| Non-owner occupied | 4,089,738 | 4,104,594 | - - | 4,156,815 | 52,092 |
| Residential real estate: | | | | | |
| Construction | - - | - - | - - | - - | - - |
| Home equity | - - | - - | - - | - - | - - |
| Other | 427,839 | 427,839 | - - | 359,707 | 26,031 |
| Commercial | - - | - - | - - | - - | - - |
| Consumer: | | | | | |
| Credit cards | - - | - - | - - | - - | - - |
| Revolving credit plans | - - | - - | - - | - - | - - |
| Other | - - | - - | - - | - - | - - |
| **With an allowance recorded:** | | | | | |
| Commercial real estate: | | | | | |
| Construction | - - | - - | - - | 907,101 | - - |
| Owner occupied | - - | - - | - - | - - | - - |
| Non-owner occupied | 936,042 | 936,042 | 136,000 | 938,516 | 38,894 |
| Residential real estate: | | | | | |
| Construction | - - | - - | - - | - - | - - |
| Home equity | - - | - - | - - | - - | - - |
| Other | 591,018 | 596,260 | 149,000 | 602,348 | 22,697 |
| Commercial | - - | - - | - - | - - | - - |
| Consumer: | | | | | |
| Credit cards | - - | - - | - - | - - | - - |
| Revolving credit plans | - - | - - | - - | - - | - - |
| Other | 18,219 | 18,219 | 2,000 | 19,671 | 1,198 |
| Total | $ 6,854,040 | $ 6,874,138 | $ 287,000 | $ 7,787,066 | $ 187,222 |

## NOTE 5 – ALLOWANCE FOR LOAN LOSSES (Continued)

Impaired loans at December 31, 2016 were as follows:

| December 31, 2016 | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
|---|---|---|---|---|---|
| **With no related allowance recorded:** | | | | | |
| Commercial real estate: | | | | | |
| Construction | $ 592,815 | $ 770,713 | $ - - | $ 206,716 | $ 6,792 |
| Owner occupied | 227,834 | 227,834 | - - | 387,999 | 29,136 |
| Non-owner occupied | 4,248,618 | 4,256,118 | - - | 4,304,825 | 53,655 |
| Residential real estate: | | | | | |
| Construction | - - | - - | - - | - - | - - |
| Home equity | - - | - - | - - | - - | - - |
| Other | 305,997 | 336,582 | - - | 326,055 | 16,119 |
| Commercial | - - | - - | - - | - - | - - |
| Consumer: | | | | | |
| Credit cards | - - | - - | - - | - - | - - |
| Revolving credit plans | - - | - - | - - | - - | - - |
| Other | - - | - - | - - | - - | - - |
| **With an allowance recorded:** | | | | | |
| Commercial real estate: | | | | | |
| Construction | 989,564 | 989,564 | 70,000 | 989,564 | - - |
| Owner occupied | - - | - - | - - | 252,926 | 21,548 |
| Non-owner occupied | - - | - - | - - | - - | - - |
| Residential real estate: | | | | | |
| Construction | - - | - - | - - | - - | - - |
| Home equity | - - | - - | - - | - - | - - |
| Other | 616,967 | 618,093 | 158,000 | 940,847 | 33,508 |
| Commercial | - - | - - | - - | - - | - - |
| Consumer: | | | | | |
| Credit cards | - - | - - | - - | - - | - - |
| Revolving credit plans | - - | - - | - - | - - | - - |
| Other | 21,735 | 21,735 | 3,000 | 23,115 | 1,403 |
| Total | $ 7,003,530 | $ 7,220,639 | $ 231,000 | $ 7,432,047 | $ 162,161 |

## NOTE 5 – ALLOWANCE FOR LOAN LOSSES (Continued)

The following tables present the aging of past due loans including nonaccrual loans as of December 31, 2017 and 2016 by class of loans:

| December 31, 2017 | 30-59 Days Past Due | 60-89 Days Past Due | 90 Days and Greater | Total Past Due | Current | Total Loans | Recorded Investment > 90 Days and Accruing |
|---|---|---|---|---|---|---|---|
| Commercial real estate: | | | | | | | |
| Construction | $ - - | $ 3,078 | $ - - | $ 3,078 | $ 9,922,865 | $ 9,925,943 | $ - - |
| Owner occupied | - - | - - | - - | - - | 16,440,764 | 16,440,764 | - - |
| Non-owner occupied | - - | - - | 2,461,101 | 2,461,101 | 20,562,237 | 23,023,338 | - - |
| Residential real estate: | | | | | | | |
| Construction | - - | - - | - - | - - | 7,512,518 | 7,512,518 | - - |
| Home equity | 4,248 | - - | - - | 4,248 | 13,754,165 | 13,758,413 | - - |
| Other | 280,892 | - - | 34,334 | 315,226 | 95,553,333 | 95,868,559 | 34,334 |
| Commercial | - - | - - | - - | - - | 6,316,833 | 6,316,833 | - - |
| Consumer: | | | | | | | |
| Credit cards | 3,233 | - - | - - | 3,233 | 318,445 | 321,678 | - - |
| Revolving credit plans | - - | - - | - - | - - | 178,351 | 178,351 | - - |
| Other | - - | - - | - - | - - | 2,657,494 | 2,657,494 | - - |
| Total | $ 288,373 | $ 3,078 | $ 2,495,435 | $ 2,786,886 | $ 173,217,005 | $ 176,003,891 | $ 34,334 |

| December 31, 2016 | 30-59 Days Past Due | 60-89 Days Past Due | 90 Days and Greater | Total Past Due | Current | Total Loans | Recorded Investment > 90 Days and Accruing |
|---|---|---|---|---|---|---|---|
| Commercial real estate: | | | | | | | |
| Construction | $ 18,186 | $ - - | $ 1,003,725 | $ 1,021,911 | $ 9,998,666 | $ 11,020,577 | $ - - |
| Owner occupied | - - | - - | - - | - - | 18,480,006 | 18,480,006 | - - |
| Non-owner occupied | - - | - - | 2,590,423 | 2,590,423 | 17,882,674 | 20,473,097 | - - |
| Residential real estate: | | | | | | | |
| Construction | - - | - - | - - | - - | 4,082,253 | 4,082,253 | - - |
| Home equity | - - | - - | - - | - - | 13,742,873 | 13,742,873 | - - |
| Other | 180,884 | 11,347 | 27,062 | 219,293 | 83,373,709 | 83,593,002 | - - |
| Commercial | - - | - - | - - | - - | 1,856,816 | 1,856,816 | - - |
| Consumer: | | | | | | | |
| Credit cards | - - | - - | - - | - - | 246,078 | 246,078 | - - |
| Revolving credit plans | - - | - - | 3,530 | 3,530 | 150,008 | 153,538 | - - |
| Other | - - | - - | - - | - - | 2,629,755 | 2,629,755 | - - |
| Total | $ 199,070 | $ 11,347 | $ 3,624,740 | $ 3,835,157 | $ 152,442,838 | $ 156,277,995 | $ - - |

## NOTE 5 – ALLOWANCE FOR LOAN LOSSES (Continued)

The following table displays the types of loans that comprised nonaccruals at December 31, 2017 and 2016:

| | 2017 | 2016 |
|---|---|---|
| Commercial real estate: | | |
| Construction | $ 936,042 | $ 1,003,725 |
| Owner occupied | - - | - - |
| Non-owner occupied | 2,461,101 | 2,590,423 |
| Residential real estate: | | |
| Construction | - - | - - |
| Home equity | - - | - - |
| Other | 88,894 | 298,168 |
| Commercial | - - | - - |
| Consumer: | | |
| Credit cards | - - | - - |
| Revolving credit plans | - - | - - |
| Other | - - | 3,530 |
| Total | $ 3,486,037 | $ 3,895,846 |

### Credit Quality Indicators

The Bank monitors credit quality indicators including risk ratings on loans to determine trends in credit quality of the loan portfolio. Every loan is assessed and assigned a risk rating by the loan officer prior to approval of the credit and monitored on an ongoing basis. The loan review policy dictates which portions of the loan portfolio will be periodically reassessed, which includes a review of the accuracy of the assigned risk ratings.

Loans are rated on a scale from pass to doubtful. The grade considers and reflects the credit worthiness, documentation and credit file completeness as well as legal and policy compliance. Each grade is described below.

Pass: Loans graded as pass are strong borrowers. The Bank will likely not incur a loss on loans graded as pass. Any inadequacies evident in financial performance and/or management sufficiency are offset by other features such as adequate collateral, good guarantors with liquid assets and/or cash flow capacity to repay the debt. Generally, loans classified as pass meet the terms of repayment but may be susceptible to deterioration if adverse factors are encountered.

Special Mention: Loans are graded as special mention when the borrower's character, credit, capacity or collateral is questionable. These weaknesses may, if not checked or corrected, weaken the asset or inadequately protect the Bank's credit position at some future date. Circumstances warrant more than normal monitoring, as these borrowers reflect the risks described in the following categories. These loans should be placed on the Bank's watchlist, and are considered adversely classified. These credits are considered bankable assets with no apparent loss of principal or interest envisioned but may require a higher level of management attention. Assets are currently protected but potentially weak. Potential weaknesses include declining trends in operating earnings and cash flows and/or reliance on the secondary source of repayment. Credits subject to economic, industry, or management factors having an adverse impact upon the credit's prospects for timely payment may also be classified as special mention.

Substandard: Loans graded as substandard are inadequately protected by the net worth and/or cash flow capacity of the borrower or of the collateral pledged. Loans graded as substandard have a borrower whose character has become suspect. The source of repayment is considered conditional, problematic or marginal. Substandard loans would include unsecured or partially secured loans to financially weak borrowers with a strong guarantor or endorser who did not benefit from the loan and without a curtailment in over one year. Some of the loans are workout loans with potential loss consideration. The credit risk in this situation relates to the possibility of some loss of principal and/or interest if the deficiencies are not corrected.

**NOTE 5 – ALLOWANCE FOR LOAN LOSSES (Continued)**

Doubtful: Loans graded as doubtful are inadequately protected by the net worth of the borrower or by the collateral pledged and repayment in full is improbable on the basis of existing facts, values and conditions. These loans may include those over two months past due that are not adequately secured or are in the process of collection. The probability of some loss is high, but because of certain important and reasonably specific pending factors, which may work to the advantage and strengthening of the facility, its classification as an estimated loss is deferred until a more exact status may be determined.

Loss: Loans graded as loss are considered uncollectible and continuance as an acceptable asset is not warranted. A loan classified as a loss is generally charged off.

The following tables display loans by credit quality indicators at December 31, 2017 and 2016:

| **December 31, 2017** | **Pass** | **Special Mention** | **Substandard** | **Doubtful** | **Total** |
|---|---|---|---|---|---|
| Commercial real estate: | | | | | |
| Construction | $ 8,645,722 | $ 716,870 | $ 563,351 | $ - - | $ 9,925,943 |
| Owner occupied | 14,829,654 | 1,611,110 | - - | - - | 16,440,764 |
| Non-owner occupied | 16,051,007 | 3,575,188 | 3,397,143 | - - | 23,023,338 |
| Residential real estate: | | | | | |
| Construction | 7,512,518 | - - | - - | - - | 7,512,518 |
| Home equity | 12,619,046 | 678,929 | 460,438 | - - | 13,758,413 |
| Other | 91,040,855 | 4,363,563 | 464,141 | - - | 95,868,559 |
| Commercial | 6,271,461 | 45,372 | - - | - - | 6,316,833 |
| Consumer: | | | | | |
| Credit cards | 321,678 | - - | - - | - - | 321,678 |
| Revolving credit plans | 178,351 | - - | - - | - - | 178,351 |
| Other | 2,638,179 | 19,315 | - - | - - | 2,657,494 |
| Total | $ 160,108,471 | $ 11,010,347 | $ 4,885,073 | $ - - | $ 176,003,891 |

| **December 31, 2016** | **Pass** | **Special Mention** | **Substandard** | **Doubtful** | **Total** |
|---|---|---|---|---|---|
| Commercial real estate: | | | | | |
| Construction | $ 8,428,034 | $ 1,010,164 | $ 1,582,379 | $ - - | $ 11,020,577 |
| Owner occupied | 16,190,211 | 2,289,795 | - - | - - | 18,480,006 |
| Non-owner occupied | 13,008,861 | 4,873,813 | 2,590,423 | - - | 20,473,097 |
| Residential real estate: | | | | | |
| Construction | 4,082,253 | - - | - - | - - | 4,082,253 |
| Home equity | 12,581,488 | 700,399 | 460,986 | - - | 13,742,873 |
| Other | 77,424,076 | 5,222,774 | 946,152 | - - | 83,593,002 |
| Commercial | 1,805,628 | 51,188 | - - | - - | 1,856,816 |
| Consumer: | | | | | |
| Credit cards | 246,078 | - - | - - | - - | 246,078 |
| Revolving credit plans | 146,607 | 3,401 | 3,530 | - - | 153,538 |
| Other | 2,608,020 | 21,735 | - - | - - | 2,629,755 |
| Total | $ 136,521,256 | $ 14,173,269 | $ 5,583,470 | $ - - | $ 156,277,995 |

## NOTE 5 – ALLOWANCE FOR LOAN LOSSES (Continued)

Loans are classified as troubled debt restructurings (TDR) when, for economic or legal reasons related to the borrower's financial position, management grants a concession to the borrower that would not have otherwise been considered. At December 31, 2017 and 2016, the Bank had a total of $2,333,016 and $2,296,897, respectively, in loans classified as troubled debt restructurings.

Troubled debt restructurings are considered subsequently defaulted once the loan is past due greater than 90 days and/or the foreclosure or repossession of collateral with a subsequent charge off of the loan. During the year ended December 31, 2017 and 2016, the Bank had no loans that subsequently defaulted during the period within twelve months of modification.

The following table details the addition to troubled debt restructurings during the year ended December 31, 2017:

| December 31, 2017 | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
|---|---|---|---|
| Residential real estate: | | | |
| Other | 1 | $ 95,143 | $ 95,143 |
| Total | 1 | $ 95,143 | $ 95,143 |

The loan was classified as a troubled debt restructuring because the loan had twelve consecutive months of interest only extensions. The loan was individually evaluated for impairment for the allowance for loan losses with no specific reserve allocation.

The Bank had no additions to troubled debt restructurings during the year ended December 31, 2016. There was one troubled debt restructuring that was modified during 2016. The following table details the modification:

| December 31, 2016 | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
|---|---|---|---|
| Residential real estate: | | | |
| Other | 1 | $ 151,698 | $ 169,033 |
| Total | 1 | $ 151,698 | $ 169,033 |

The loan was previously classified as a troubled debt restructuring because of an extended term and below market rate for similar risk. The loan was refinanced and modified to further extend the term and lower the rate. A charged off consumer loan was added to the principal of the loan at the time of modification.

## NOTE 6 – OTHER REAL ESTATE OWNED

The table below reflects changes in other real estate owned (OREO) for the years ended:

| | 2017 | 2016 |
|---|---|---|
| Balance, beginning of year | $ 75,900 | $ 844,967 |
| Properties acquired at foreclosure | - - | 189,000 |
| Sale of foreclosed properties | (62,400) | (782,498) |
| Valuation adjustments | (13,500) | (175,569) |
| Balance, end of year | $ - - | $ 75,900 |

Net expense applicable to OREO, other than valuation adjustments, was $2,613 and $14,288 for the years ended December 31, 2017 and 2016, respectively.

There were no residential real estate loans included in the carrying amount of OREO at December 31, 2016. The Bank did not have any residential real estate loans for which formal foreclosure proceedings were in process as of December 31, 2017.

## NOTE 7 – PREMISES AND EQUIPMENT

A summary of the cost and accumulated depreciation of premises and equipment follows:

| | December 31, | |
|---|---|---|
| | 2017 | 2016 |
| Land | $ 1,580,761 | $ 1,580,761 |
| Buildings and improvements | 8,491,871 | 8,370,669 |
| Furniture and equipment | 3,983,724 | 3,921,513 |
| Total cost | 14,056,356 | 13,872,943 |
| Less accumulated depreciation | (7,981,878) | (7,499,704) |
| Premises and equipment, net | $ 6,074,478 | $ 6,373,239 |

Depreciation expense for the years ended December 31, 2017 and 2016 totaled $556,068 and $537,079, respectively.

## NOTE 8 – DEPOSITS

The Bank makes every effort to obtain deposits to fund loan growth or the growth of the securities portfolio. The Bank had two deposit relationships that, collectively, represented 19.97% of total deposits at December 31, 2017 and two deposit relationships that, collectively, represented 19.09% of total deposits at December 31, 2016.

The aggregate amount of time deposit accounts in denominations of $250,000 or more at December 31, 2017 and 2016 was $3,089,191 and $7,600,887, respectively.

Brokered deposits totaled $100,086 at December 31, 2017. There were no brokered deposits at December 31, 2016. Brokered deposits are placed through the Certificate of Deposit Account Registry Service (CDARS) or Insured Cash Sweep (ICS).

At December 31, 2017, the scheduled maturities of time deposits were as follows:

| | |
|---|---|
| 2018 | $ 20,736,358 |
| 2019 | 6,348,811 |
| 2020 | 3,350,224 |
| 2021 | 3,530,941 |
| 2022 | 3,116,126 |
| | $ 37,082,460 |

## NOTE 9 – BORROWINGS

***Securities Sold Under an Agreement to Repurchase***

Securities sold under an agreement to repurchase, which are classified as secured borrowings, generally mature within one to four days from the transaction date. Securities sold under an agreement to repurchase are reflected as the amount of cash received in connection with the transaction. The Bank may be required to provide additional collateral based on the fair value of the underlying securities. Pledged securities related to securities sold under an agreement to repurchase are discussed in Note 3, Notes to Consolidated Financial Statements. Securities sold under an agreement to repurchase amounted to $1,616,969 and $804,962 at December 31, 2017 and 2016, respectively.

***Federal Home Loan Bank Advances***

The Bank is a member of the Federal Home Loan Bank of Pittsburgh (FHLB) which allows for participation in FHLB borrowing programs. At December 31, 2017, the Bank had a maximum borrowing capacity with the FHLB of $75,456,550 which is unrestricted and does not require the Bank to pledge securities or make other commitments. Under the terms of the agreement, advances from the FHLB are collateralized by one-to-four family mortgage loans totaling approximately $102,248,000 and $91,164,000 at December 31, 2017 and 2016, respectively, and Federal Home Loan Bank stock with a book value of $315,600 and $626,400, respectively. This borrowing capacity has no scheduled maturity date. The Bank had outstanding advances from the FHLB of $637,600 and $8,712,700 at December 31, 2017 and 2016, respectively. The outstanding advances on December 31, 2017 were overnight borrowings at a rate of 1.54%.

***Available Lines of Credit***

At December 31, 2017, the Bank had lines of credit available with various financial institutions totaling $12,000,000 for the purchase of federal funds. The Bank had no outstanding borrowing against these lines as of December 31, 2017 and December 31, 2016. The Bank has an agreement with the Federal Reserve Bank to borrow from the discount window, which is classified as a short term borrowing. In order to borrow funds under this agreement, the Bank must pledge securities to the Federal Reserve Bank. As of December 31, 2017 and 2016, the Bank had no borrowings from the discount window.

## NOTE 10 – EMPLOYEE BENEFIT PLANS

***Pension Plan***

As of December 31, 2013, the defined benefit pension plan was frozen. The pension plan's funded status as of December 31, 2017 and 2016 follows. The amounts shown below are recognized in the Bank's consolidated balance sheets as of December 31, 2017 and 2016.

| | 2017 | 2016 |
|---|---|---|
| Change in benefit obligation: | | |
| Beginning benefit obligation | $ 9,203,342 | $ 9,065,095 |
| Interest cost | 389,803 | 407,862 |
| Actuarial loss | 583,579 | 75,667 |
| Benefits paid | (358,277) | (345,282) |
| Ending benefit obligation | $ 9,818,447 | $ 9,203,342 |
| Change in plan assets, at fair value: | | |
| Beginning plan assets | $ 9,680,945 | $ 9,777,027 |
| Actual return on plan assets | 1,405,338 | 249,200 |
| Employer contribution | - - | - - |
| Benefits paid | (358,277) | (345,282) |
| Ending plan assets | $ 10,728,006 | $ 9,680,945 |
| Funded status | $ 909,559 | $ 477,603 |
| Accrued benefit asset recognized on the consolidated balance sheets at December 31 | $ 909,559 | $ 477,603 |
| Amounts recognized in accumulated other comprehensive loss: | | |
| Net loss | $ 3,209,425 | $ 3,492,692 |
| Deferred tax asset | (802,356) | (1,327,223) |
| Net amount recognized | $ 2,407,069 | $ 2,165,469 |

The accumulated benefit obligation for the defined benefit plan was $9,818,477 and $9,203,342 at December 31, 2017 and 2016, respectively.

At December 31, 2017 and 2016, the assumptions used to determine the benefit obligation are as follows:

| | 2017 | 2016 |
|---|---|---|
| Discount rate | 3.75% | 4.35% |
| Expected rate of return on plan assets | 6.47% | 6.21% |

**NOTE 10 – EMPLOYEE BENEFIT PLANS (Continued)**

The components of net periodic (benefit) cost, other amounts recognized in other comprehensive (income) loss and the assumptions used to determine net periodic pension (benefit) cost are as follows:

| | 2017 | 2016 |
|---|---|---|
| **Components of net periodic benefit cost:** | | |
| Interest cost | $ 389,803 | $ 407,862 |
| Expected return on plan assets | (621,894) | (645,443) |
| Net amortization and deferral | 83,402 | 79,194 |
| Net periodic benefit income | (148,689) | (158,387) |
| **Other changes in plan assets and benefit obligations recognized in other comprehensive (income) loss:** | | |
| Net actuarial (gain) loss at December 31 | (199,865) | 471,910 |
| Amortization of net loss | (83,402) | (79,194) |
| Total recognized in other comprehensive (income) loss | (283,267) | 392,716 |
| Total recognized in net periodic benefit cost and other comprehensive (income) loss | $ (431,956) | $ 234,329 |
| Discount rate | 4.35% | 4.61% |
| Expected rate of return on plan assets | 6.21% | 6.61% |

The estimated net actuarial loss for the defined benefit pension plan that will be amortized from accumulated other comprehensive loss into net periodic benefit cost over the next fiscal year is $100,141.

*Determination of Expected Long-term Rate of Return*

The expected long-term rate of return for the plan's total assets is based on the expected return of each of the below categories, weighted based on the median of the target allocation for each class.

The Bank's pension plan weighted average asset allocations at December 31, 2017 and 2016 are as follows:

| | Percentage of Plan Assets at December 31, | |
|---|---|---|
| **Asset Category** | **2017** | **2016** |
| Equity Securities | 60% | 59% |
| Debt Securities | 38% | 39% |
| Cash | 2% | 2% |
| Total | 100% | 100% |

**NOTE 10 – EMPLOYEE BENEFIT PLANS (Continued)**

The following tables present the balance of plan assets measured at fair value on a recurring basis as of December 31, 2017 and 2016:

| Description | Balance as of December 31, 2017 | Fair Value Measurements at Report Date Using: Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| **Cash** | $ 220,834 | $ 220,834 | $ - - | $ - - |
| **Equity Securities** | | | | |
| U.S. Large cap | 4,229,988 | 4,229,988 | - - | - - |
| U.S. Mid cap | 899,951 | 899,951 | - - | - - |
| U.S. Small cap | 233,301 | 233,301 | - - | - - |
| International | 1,052,127 | 1,052,127 | - - | - - |
| **Fixed Income Securities** | | | | |
| Core fixed income | 3,936,125 | - - | 3,936,125 | - - |
| International | 155,680 | - - | 155,680 | - - |
| Total | $ 10,728,006 | $ 6,636,201 | $ 4,091,805 | $ - - |

| Description | Balance as of December 31, 2016 | Fair Value Measurements at Report Date Using: Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| **Cash** | $ 157,039 | $ 157,039 | $ - - | $ - - |
| **Equity Securities** | | | | |
| U.S. Large cap | 3,609,554 | 3,609,554 | - - | - - |
| U.S. Mid cap | 965,080 | 965,080 | - - | - - |
| U.S. Small cap | 237,927 | 237,927 | - - | - - |
| International | 924,093 | 924,093 | - - | - - |
| **Fixed Income Securities** | | | | |
| Core fixed income | 3,509,259 | - - | 3,509,259 | - - |
| International | 277,993 | - - | 277,993 | - - |
| Total | $ 9,680,945 | $ 5,893,693 | $ 3,787,252 | $ - - |

**NOTE 10 – EMPLOYEE BENEFIT PLANS (Continued)**

*Investment Policy and Strategy*

The policy, as established by the Pension Committee, is to invest assets in a diversified portfolio per target allocations. The assets will be reallocated periodically to meet the target allocations of 60% equity securities and 40% debt securities. The investment policy will be reviewed periodically, under the advisement of a registered investment advisor.

The overall investment objective is to provide for long-term growth of capital through participation in the equity markets with a moderate level of income. The investment time horizon is estimated at five to ten years. The investment return objective is to achieve a return greater than a blended mix of stated indices tailored to the same asset mix of the plan assets by 0.5% after fees over a rolling five-year moving average basis.

Allowable assets include cash equivalents, taxable bonds, U.S. equity securities, international equity securities, institutional mutual funds and guaranteed investment contracts (GICs).

In order to achieve a prudent level of portfolio diversification, the securities of any one company should not exceed more than 10% of the total plan assets, and no more than 25% of total plan assets should be invested in any one industry (other than securities of the U.S. Government or Agencies). Additionally, no more than 20% of the plan assets shall be invested in foreign securities (both equity and fixed).

The Bank does not expect to make any contributions to the plan in 2018.

Estimated future benefit payments are as follows:

| | |
|---|---|
| 2018 | $ 501,000 |
| 2019 | 509,000 |
| 2020 | 529,000 |
| 2021 | 531,000 |
| 2022 | 533,000 |
| 2023 to 2027 | 2,695,000 |

**NOTE 10 – EMPLOYEE BENEFIT PLANS (Continued)**

***Supplemental Executive Retirement Plan***

In 2014, the Bank provided a supplemental executive retirement plan for senior management. The plan's funded status as of December 31, 2017 and 2016 follows. The amounts shown below are recognized in the Bank's consolidated balance sheet as of December 31, 2017 and 2016.

| | 2017 | 2016 |
|---|---|---|
| Change in benefit obligation: | | |
| Beginning benefit obligation | $ 645,814 | $ 445,779 |
| Service cost | 49,878 | 34,576 |
| Interest cost | 29,609 | 21,196 |
| Plan amendments | - - | - - |
| Actuarial loss | 55,722 | 152,767 |
| Benefits paid | (12,756) | (8,504) |
| Ending benefit obligation | $ 768,267 | $ 645,814 |
| Change in plan assets, at fair value: | | |
| Beginning plan assets | $ - - | $ - - |
| Employer contributions | 12,756 | 8,504 |
| Actual benefits paid | (12,756) | (8,504) |
| Ending plan assets | $ - - | $ - - |
| Funded status | $ (768,267) | $ (645,814) |
| Accrued benefit liability recognized on the consolidated balance sheet at December 31 | $ (768,267) | $ (645,814) |
| Amounts recognized in accumulated other comprehensive loss: | | |
| Net loss | $ 99,004 | $ 43,282 |
| Prior service cost | 272,688 | 317,172 |
| Deferred tax asset | (92,923) | (136,972) |
| Net amount recognized | $ 278,769 | $ 223,482 |

The accumulated benefit obligation for the supplemental executive retirement plan was $768,267 and $645,814 at December 31, 2017 and 2016, respectively.

At December 31, 2017 and 2016, the assumptions used to determine the benefit obligation are as follows:

| | 2017 | 2016 |
|---|---|---|
| Discount rate | 3.95% | 4.63% |
| Rate of compensation increase | 3.00% | 3.00% |

**NOTE 10 – EMPLOYEE BENEFIT PLANS (Continued)**

The components of net periodic benefit cost, other amounts recognized in other comprehensive (income) loss and the assumptions used to determine net periodic benefit cost are as follows:

| | 2017 | 2016 |
|---|---|---|
| **Components of net periodic benefit cost:** | | |
| Service cost | $ 49,878 | $ 34,576 |
| Interest cost | 29,609 | 21,196 |
| Amortization of prior service cost | 44,484 | 44,484 |
| Amortization of net gain | - - | (6,072) |
| Net periodic benefit cost | 123,971 | 94,184 |
| **Other changes in plan assets and benefit obligations recognized in other comprehensive (income) loss :** | | |
| Net actuarial loss at December 31 | 55,722 | 152,767 |
| Prior service cost | - - | - - |
| Amortization of prior service cost | (44,484) | (44,484) |
| Amortization of gain | - | 6,072 |
| Total recognized in other comprehensive (income) loss | 11,238 | 114,355 |
| Total recognized in net periodic benefit cost and other comprehensive (income) loss | $ 135,209 | $ 208,539 |
| Discount rate | 4.63% | 4.80% |
| Rate of compensation increase | 3.00% | 3.00% |

There is no estimated net actuarial loss for the supplemental executive retirement to be amortized from accumulated other comprehensive loss into net periodic benefit cost over the next fiscal year.

The Bank will make a contribution to the plan of $12,756 in 2018.

Estimated future benefit payments are as follows:

| | |
|---|---|
| 2018 | $ 12,756 |
| 2019 | 13,605 |
| 2020 | 13,827 |
| 2021 | 14,082 |
| 2022 | 14,220 |
| 2023 to 2027 | 137,458 |

***401(k) Plan***

The Bank has a 401(k) Plan whereby employees age 21 and over who have worked at least one year with 1,000 hours of service may participate in the Plan. The Bank makes matching contributions equal to 25 percent of the first five percent of an employee's compensation contributed to the Plan. Matching contributions vest to the employee over a five-year period based on a tiered schedule. Starting on January 1, 2014, the Bank contributed a percentage of each eligible employees' salary to their 401(k) Plan account in addition to matching contributions. For the years ended December 31, 2017 and 2016, the matching contribution expense attributable to the Plan amounted to $32,998 and $30,341, respectively.

**NOTE 11 – INCOME TAXES**

The Bank files income tax returns in the U.S. federal jurisdiction and the states of West Virginia and Maryland. With few exceptions, the Bank is no longer subject to U.S. federal, state and local income tax examinations by tax authorities for years prior to 2014.

Allocation of federal and state income taxes between current and deferred portions is as follows for the years ended December 31, 2017 and 2016:

| | 2017 | 2016 |
|---|---|---|
| Federal | | |
| Current | $ 399,683 | $ 223,179 |
| Deferred | 12,504 | (36,474) |
| | 412,187 | 186,705 |
| State | | |
| Current | 68,097 | 17,691 |
| Deferred | (4,697) | 24,614 |
| | 63,400 | 42,305 |
| Deferred tax asset adjustment for enacted change in tax rate | 385,241 | - - |
| Income tax expense | $ 860,828 | $ 229,010 |

Income tax expense for 2017 includes a revaluation adjustment of the net deferred tax assets in the amount of $385,241. This expense was recorded as a result of the enactment of the Tax Cuts and Jobs Act on December 22, 2017. The act reduced the federal income tax rate for corporations from 35% to 21% effective January 1, 2018.

Effective tax rates differ from the statutory federal income tax rate due to the following:

| | 2017 | 2016 |
|---|---|---|
| Federal statutory rate | 34.0% | 34.0% |
| Increase (decrease) resulting from: | | |
| Tax-exempt income | (14.7) | (22.6) |
| State taxes, net of federal income tax effect | 0.9 | 0.9 |
| Tax impact from enacted change in tax rate | 16.8 | - - |
| Nondeductible expenses and other, net | 0.6 | 2.2 |
| | 37.6% | 14.5% |

## NOTE 11 – INCOME TAXES (Continued)

The components of the net deferred tax asset, included in other assets, are as follows:

| | December 31, 2017 | December 31, 2016 |
|---|---|---|
| Deferred tax assets: | | |
| Allowance for loan losses | $ 226,500 | $ 293,741 |
| Allowance for other real estate owned | - - | 15,825 |
| Tax basis adjustment for other real estate owned | - - | 17,008 |
| Deferred real estate gains | 7,679 | 12,138 |
| Deferred loan fees | 110,164 | 102,771 |
| Nonaccrual loan income | 233,921 | 398,255 |
| Supplemental executive retirement benefits, net | 293,749 | 402,598 |
| Alternative minimum tax credit | 828,198 | 474,486 |
| Net unrealized loss on available for sale securities | 218,597 | 329,795 |
| Net operating loss carryforwards | - - | 406,403 |
| Home equity expenses | 5,002 | - - |
| Other | 13,615 | 22,707 |
| | 1,937,425 | 2,475,727 |
| Deferred tax liabilities: | | |
| Fixed assets, net | (131,393) | (216,651) |
| Pension benefits, net | (227,390) | (181,489) |
| Accretion on investment securities | (9,596) | (14,339) |
| | (368,379) | (412,479) |
| Net deferred tax asset | $ 1,569,046 | $ 2,063,248 |

## NOTE 12 – RELATED PARTY TRANSACTIONS

The Bank had, and may be expected to have in the future, banking transactions in the ordinary course of business with directors, executive officers, their immediate families and affiliated companies in which they are principal shareholders (commonly referred to as related parties), on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others. Loans to these parties totaled $3,208,205 and $2,250,473 at December 31, 2017 and 2016, respectively. During 2017, total principal additions were $1,259,050 and total principal payments were $300,789. In 2017, there was a change in related party relationships which resulted in a decrease in the balance of loans related to these parties of $529. Deposits from related parties held by the Bank at December 31, 2017 and 2016 amounted to $1,217,993 and $845,893, respectively.

## NOTE 13 – COMMITMENTS, OFF-BALANCE SHEET RISK AND CONTINGENCIES

There are various contingent liabilities that are not reflected in the consolidated financial statements, including claims and legal actions arising in the ordinary course of business. In the opinion of management, after consultation with legal counsel, the ultimate disposition of these matters is not expected to have a material effect on the financial condition or results of operations of the Bank.

Some financial instruments are used in the normal course of business to meet the financing needs of customers and to reduce exposure to interest rate changes. These financial instruments include commitments to extend credit and standby letters of credit, which involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated financial statements.

Exposure to credit loss, if the other party does not perform, is represented by the contractual amount of these commitments to extend credit and standby letters of credit. The same credit policies are used for commitments and conditional obligations as are used for loans.

A summary of the notional or contractual amounts of financial instruments with off-balance sheet risk at year end follows:

| | December 31, 2017 | December 31, 2016 |
|---|---|---|
| Commitments to extend credit | $ 7,050,000 | $ 4,008,000 |
| Unfunded commitments | 33,913,000 | 25,579,000 |
| Standby letters of credit | 1,007,000 | 1,160,000 |

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the commitment. 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 used, the total commitments do not necessarily represent future cash requirements.

Unfunded commitments under commercial lines-of-credit, revolving credit lines and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These lines of credit are collateralized as deemed necessary and usually do not contain a specified maturity date and may not be drawn upon to the total extent to which the Bank is committed.

Standby letters of credit are conditional lending commitments issued by the Bank to guarantee the performance of a customer to a third party. Letters of credit are primarily issued to support public and private borrowing arrangements. Essentially all letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

The Bank generally holds collateral supporting these commitments. The amount of collateral obtained, if deemed necessary, is based upon management's credit evaluation of the customer. The Bank is required to maintain average balances on hand or with the Federal Reserve Bank. At December 31, 2017 and 2016, reserve balances amounted to $856,000 and $675,000, respectively.

## NOTE 14 – FAIR VALUE MEASUREMENTS

The Bank follows Accounting Standards Codification (ASC) 820, *Fair Value Measurements and Disclosures*, to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. ASC 820 clarifies that fair value of certain assets and liabilities is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants.

ASC 820 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Bank's market assumptions. The three levels of the fair value hierarchy under ASC 820 based on these two types of inputs are as follows:

Level 1 – Valuation is based on quoted prices in active markets for identical assets and liabilities.

Level 2 – Valuation is based on observable inputs including quoted prices in active markets for similar assets and liabilities, quoted prices for identical or similar assets and liabilities in less active markets, and model-based valuation techniques for which significant assumptions can be derived primarily from or corroborated by observable data in the market.

Level 3 – Valuation is based on model-based techniques that use one or more significant inputs or assumptions that are unobservable in the market.

The following describes the valuation techniques used by the Bank to measure certain assets and liabilities recorded at fair value on a recurring basis in the consolidated financial statements:

<u>Securities Available for Sale</u>: Securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, when available (Level 1). If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar securities for which significant assumptions are derived primarily from or corroborated by observable market data. Third party vendors compile prices from various sources and may determine the fair value of identical or similar securities by using pricing models that consider observable market data (Level 2).

The following table presents the balance of assets measured at fair value on a recurring basis as of December 31, 2017:

| | | Fair Value Measurements at Reporting Date Using | | |
|---|---|---|---|---|
| **Description** | **Balance as of December 31, 2017** | **Quoted Prices in Active Markets for Identical Assets (Level 1)** | **Significant Other Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** |
| Securities Available for Sale | | | | |
| U.S. Government and agency | $ 70,202,241 | $ - - | $ 70,202,241 | $ - - |
| State and municipal | 25,312,717 | - - | 25,312,717 | - - |
| | $ 95,514,958 | $ - - | $ 95,514,958 | $ - - |

**NOTE 14 – FAIR VALUE MEASUREMENTS (Continued)**

The following table presents the balance of assets measured at fair value on a recurring basis as of December 31, 2016:

| Description | Balance as of December 31, 2016 | Fair Value Measurements at Reporting Date Using: Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| Securities Available for Sale | | | | |
| U.S. Government and agency | $ 69,921,540 | $ - - | $ 69,921,540 | $ - - |
| State and municipal | 37,550,160 | - - | 37,550,160 | - - |
| | $ 107,471,700 | $ - - | $ 107,471,700 | $ - - |

Certain assets are measured at fair value on a nonrecurring basis in accordance with GAAP. Adjustments to the fair value of these assets usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets.

The following describes the valuation techniques used by the Bank to measure certain assets recorded at fair value on a nonrecurring basis in the consolidated financial statements:

Impaired Loans: Loans are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts due according to the contractual terms of the loan agreements will not be collected. The measurement of loss associated with impaired loans can be based on either the observable market price of the loan, the fair value of the collateral or present value of cash flows. Collateral may be in the form of real estate or business assets including equipment, inventory and accounts receivable. The vast majority of the Bank's collateral is real estate. The value of real estate collateral is determined utilizing a market valuation approach based on an appraisal, of one year or less, conducted by an independent, licensed appraiser using observable market data (Level 2). However, if the collateral is a house or building in the process of construction or if an appraisal of the property is more than one year old and not solely based on observable market comparables or management determines the fair value of the collateral is further impaired below the appraised value, then a Level 3 valuation is considered to measure the fair value. The value of business equipment is based upon an outside appraisal, of one year or less, if deemed significant, or the net book value on the applicable business's financial statements if not considered significant using observable market data. Likewise, values for inventory and accounts receivables collateral are based on financial statement balances or aging reports (Level 3). Impaired loans allocated to the allowance for loan losses are measured at fair value on a nonrecurring basis. Any fair value adjustments are recorded in the period incurred as provision for loan losses on the Consolidated Statements of Income.

Other Real Estate Owned: Loans are transferred to other real estate owned when the collateral securing them is foreclosed upon. The measurement of loss associated with other real estate owned is based on the fair value of the collateral compared to the unpaid loan balance and anticipated costs to sell the property and initial losses are charged against the allowance for loan losses at the time of the transfer. Subsequent to transfer, fair values are determined in a similar manner to impaired loans secured by real estate previously discussed. Any additional fair value adjustments to other real estate owned are recorded in the period incurred and expensed against current earnings through a valuation allowance for other real estate owned.

## NOTE 14 – FAIR VALUE MEASUREMENTS (Continued)

The following tables present the balances of assets and liabilities measured at fair value on a nonrecurring basis as of December 31, 2017 and 2016:

| Description | Fair Value as of December 31, 2017 | Fair Value Measurements at Reporting Date Using: Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| Assets: | | | | |
| Impaired Loans, net | $ 1,258,279 | $ - - | $ - - | $ 1,258,279 |

| Description | Fair Value as of December 31, 2016 | Fair Value Measurements at Reporting Date Using: Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| Assets: | | | | |
| Impaired Loans, net | $ 1,397,266 | $ - - | $ - - | $ 1,397,266 |
| Other Real Estate Owned, net | $ 75,900 | $ - - | $ - - | $ 75,900 |

The following table displays quantitative information about Level 3 Fair Value Measurements for December 31, 2017 (dollars in thousands):

| Assets | Quantitative Information about Level 3 Fair Value Measurements for December 31, 2017: Fair Value | Valuation Technique | Unobservable Input | Range (Weighted Average) |
|---|---|---|---|---|
| Impaired Loans, net | $ 989 | Discounted appraised value | Selling cost | 6% - 9% (6%) |
| | 269 | Present value of future cash flows | Discount rate | 6% - 18% (7%) |

The following methods and assumptions were used to estimate fair values for assets and liabilities:

- Carrying amount is considered to estimate fair value for cash and due from financial institutions, interest bearing deposits with depository institutions, accrued interest receivable, securities sold under an agreement to repurchase, accrued interest payable and variable rate loans or deposits that re-price frequently.
- Securities fair values are based on quoted market prices or, if no quotes are available, on the rate and term of the security, on information about the issuer and third party pricing models.
- The carrying value of restricted securities approximates fair value based on the redemption provisions of the respective entity.
- Fixed rate loans and variable rate loans with infrequent repricing or repricing limits, are estimated using discounted cash flow analyses or underlying collateral values, where applicable.
- The fair value of demand and savings deposits is the amount payable on demand. The fair value of certificates of deposit is estimated using the rates currently offered for deposits with similar maturities.
- Bank owned life insurance represents insurance policies on past and current officers and directors of the Bank. The cash values of the polices are estimates using information provided by insurance carriers. These policies are carried at their cash surrender value which approximates fair value.

- The carrying amount of Federal Home Loan Bank advances and other short term borrowings maturing within ninety days is considered to approximate fair value. Fair values of all other borrowings are estimated using a discounted cash flow analysis based on the Bank's current incremental borrowing rate for similar types of borrowing arrangements.
- Fair value of other financial instruments and off-balance sheet items are not considered significant to this presentation.

While these estimates of fair value are based on management's judgment of the most appropriate factors, there is no assurance that if the Bank had disposed of such items at December 31, 2017 and 2016, the estimated fair values would have been achieved. Market values may differ depending on various circumstances not taken into consideration in this methodology. The estimated fair values at December 31, 2017 and 2016 should not necessarily be considered to apply at subsequent dates.

The following table shows the estimated fair values and the related carrying values of the Bank's financial instruments at December 31, 2017:

| (dollars in thousands) | December 31, 2017 | | Fair Value Measurements at Reporting Date Using | | |
|---|---|---|---|---|---|
| | Carrying Amount | Estimated Fair Value | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| **Financial assets:** | | | | | |
| Cash and due from financial institutions | $ 4,890 | $ 4,890 | $ 4,890 | $ - - | $ - - |
| Interest bearing deposits with depository institutions | 51 | 51 | 51 | - - | - - |
| Securities available for sale | 95,515 | 95,515 | - - | 95,515 | - - |
| Securities held to maturity | 4,137 | 4,207 | - - | 4,207 | - - |
| Restricted securities | 396 | 396 | - - | 396 | - - |
| Loans, net | 173,681 | 177,131 | - - | - - | 177,131 |
| Accrued interest receivable | 866 | 866 | - - | 866 | - - |
| Bank owned life insurance | 6,053 | 6,053 | - - | 6,053 | - - |
| **Financial liabilities:** | | | | | |
| Deposits | $ 267,760 | $ 267,712 | $ - - | $ 230,677 | $ 37,035 |
| Securities sold under an agreement to repurchase | 1,617 | 1,617 | - - | 1,617 | - - |
| Accrued interest payable | 27 | 27 | - - | 27 | - - |
| Federal Home Loan Bank advances | 638 | 638 | 638 | - - | - - |

**NOTE 14 – FAIR VALUE MEASUREMENTS (Continued)**

The following table shows the estimated fair values and the related carrying values of the Bank's financial instruments at December 31, 2016:

| (dollars in thousands) | December 31, 2016 | | Fair Value Measurements at Reporting Date Using | | |
|---|---|---|---|---|---|
| | Carrying Amount | Estimated Fair Value | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| **Financial assets:** | | | | | |
| Cash and due from financial institutions | $ 4,698 | $ 4,698 | $ 4,698 | $ - - | $ - - |
| Interest bearing deposits with depository institutions | 51 | 51 | 51 | - - | - - |
| Securities available for sale | 107,472 | 107,472 | - - | 107,472 | - - |
| Securities held to maturity | 4,621 | 4,692 | - - | 4,692 | - - |
| Restricted securities | 707 | 707 | - - | 707 | - - |
| Loans, net | 154,225 | 155,714 | - - | - - | 155,714 |
| Accrued interest receivable | 932 | 932 | - - | 932 | - - |
| Bank owned life insurance | 5,890 | 5,890 | - - | 5,890 | - - |
| **Financial liabilities:** | | | | | |
| Deposits | $ 255,514 | $ 255,528 | $ - - | $ 210,306 | $ 45,222 |
| Securities sold under an agreement to repurchase | 805 | 805 | - - | 805 | - - |
| Accrued interest payable | 43 | 43 | - - | 43 | - - |
| Federal Home Loan Bank advances | 8,713 | 8,713 | 8,713 | - - | - - |

***Interest Rate Risk***

The Bank assumes interest rate risk, the risk that general interest rate levels will change, as a result of its normal operations. As a result, the fair values of the Bank's financial instruments will change when interest rate levels change and that change may be either favorable or unfavorable to the Bank. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk. However, borrowers with fixed rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates and maturities of assets and liabilities and attempts to minimize interest rate risk by adjusting terms of new loans and deposits and by investing in securities with terms that mitigate the Bank's overall interest rate risk.

## NOTE 15 – REGULATORY MATTERS

The Bank is subject to various regulatory capital requirements administered by the 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 consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of its assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

The final rules implementing Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III rules) became effective on January 1, 2015, with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. As part of the new requirements, the Common Equity Tier I Capital ratio is calculated and utilized in the assessment of capital for all institutions.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios as presented in the table below of Total capital, Tier 1 capital and Common Equity Tier 1 capital (as defined in the regulations) to risk weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2017 and 2016, that the Bank met all capital adequacy requirements to which it is subject.

Under the Basel III rules, the capital conservation buffer of 0.625% was effective January 1, 2016. The buffer will be fully phased-in through equal installments of 0.625% each year until reaching 2.5% in January 2019. The purpose of the capital conservation buffer is to absorb losses during periods of economic stress and requires increased capital levels for the purpose of capital distributions and other payments. Failure to maintain the buffer will result in restrictions on the Bank's ability to make capital distributions and pay discretionary bonuses to executive officers. The Bank's capital conservation buffer was 8.76% and 8.71% as of December 31, 2017 and 2016, respectively.

As of December 31, 2017, the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based, Common Equity Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following table. There are no conditions or events since the notification that management believes have changed the Bank's category. The Bank's capital amounts (dollars in thousands) and ratios as of December 31, 2017 and 2016 are also presented in the following table.

| | Actual | | Minimum For Capital Adequacy Purposes | | Minimum For Capital Adequacy with Capital Conservation Buffer | | Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions | |
|---|---|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| **2017** | | | | | | | | |
| Total capital (to risk weighted assets) | $ 27,938 | 16.74% | $ 13,352 | 8.00% | $ 15,438 | 9.25% | $ 16,690 | 10.00% |
| Tier 1 capital (to risk weighted assets) | $ 26,056 | 15.61% | $ 10,014 | 6.00% | $ 12,100 | 7.25% | $ 13,352 | 8.00% |
| Common equity tier 1 (to risk weighted assets) | $ 26,056 | 15.61% | $ 7,511 | 4.50% | $ 9,597 | 5.75% | $ 10,849 | 6.50% |
| Tier 1 capital (to average assets) | $ 26,056 | 8.76% | $ 11,899 | 4.00% | N/A | N/A | $ 14,874 | 5.00% |
| **2016** | | | | | | | | |
| Total capital (to risk weighted assets) | $ 26,144 | 16.71% | $ 12,516 | 8.00% | $ 13,494 | 8.625% | $ 15,645 | 10.00% |
| Tier 1 capital (to risk weighted assets) | $ 24,362 | 15.57% | $ 9,387 | 6.00% | $ 10,365 | 6.625% | $ 12,516 | 8.00% |
| Common equity tier 1 (to risk weighted assets) | $ 24,362 | 15.57% | $ 7,040 | 4.50% | $ 8,018 | 5.125% | $ 10,169 | 6.50% |
| Tier 1 capital (to average assets) | $ 24,362 | 8.46% | $ 11,512 | 4.00% | N/A | N/A | $ 14,391 | 5.00% |

## NOTE 16 – ACCUMULATED OTHER COMPREHENSIVE LOSS

Changes in each component of accumulated other comprehensive loss were as follows:

| | Net Unrealized Gains (Losses) on Securities | Unrealized Losses on Securites Transferred to Held to Maturity | Adjustments Related to Pension Benefits | Adjustments Related to Supplemental Executive Retirement Benefits | Accumulated Other Comprehensive (Loss) |
|---|---|---|---|---|---|
| **Balance at December 31, 2015** | $ 491,296 | $ (1,188,542) | $ (1,921,985) | $ (152,581) | $ (2,771,812) |
| Unrealized holding losses on available for sale securities, net of tax ($597,031) | (974,102) | - - | - - | - - | (974,102) |
| Reclassification adjustment, net of tax ($33,881) | (55,280) | - - | - - | - - | (55,280) |
| Amortization of unrealized holding losses on securities transferred to held to maturity, net of tax $27,135 | - - | 44,274 | - - | - - | 44,274 |
| Reversal of unrealized holding losses on securities transferred to held to maturity, net of tax $701,326 | - - | 1,144,268 | - - | - - | 1,144,268 |
| Change in pension benefits, net of tax ($179,326) | - - | - - | (292,584) | - - | (292,584) |
| Reclassification adjustment, net of tax $30,094 | - - | - - | 49,100 | - - | 49,100 |
| Change in supplemental executive retirement benefits, net of tax ($58,051) | - - | - - | - - | (94,716) | (94,716) |
| Reclassification adjustment, net of tax $14,597 | - - | - - | - - | 23,815 | 23,815 |
| **Balance at December 31, 2016** | $ (538,086) | $ - - | $ (2,165,469) | $ (223,482) | $ (2,927,037) |
| Unrealized holding gains on available for sale securities, net of tax $41,671 | 67,990 | - - | - - | - - | 67,990 |
| Reclassification adjustment, net of tax ($44,144) | (72,023) | - - | - - | - - | (72,023) |
| Change in pension benefits, net of tax $75,949 | - - | - - | 123,916 | - - | 123,916 |
| Reclassification adjustment, net of tax $31,693 | - - | - - | 51,709 | - - | 51,709 |
| Change in supplemental executive retirement benefits, net of tax ($21,175) | - - | - - | - - | (34,547) | (34,547) |
| Reclassification adjustment, net of tax $16,904 | - - | - - | - - | 27,580 | 27,580 |
| Reclassification adjustment of stranded tax effects from change in tax rate | (113,671) | - - | (417,225) | (48,320) | (579,216) |
| **Balance at December 31, 2017** | $ (655,790) | $ - - | $ (2,407,069) | $ (278,769) | $ (3,341,628) |

**NOTE 16 – ACCUMULATED OTHER COMPREHENSIVE LOSS (Continued)**

Reclassification out of accumulated other comprehensive loss for December 2017 and 2016 is as follows:

| Details about Accumulated Other Comprehensive Loss Components | Amount Reclassified from Accumulated Other Comprehensive Loss | Affected Line Item in the Statement Where Net Income is Presented |
|---|---|---|
| **December 31, 2017** | | |
| Amortization of defined benefit pension items | | |
| Net actuarial loss | $ (83,402) [1] | |
| Amortization of supplemental executive retirement benefit items | | |
| Prior service cost | (44,484) [2] | |
| Reclassification adjustment for gains on available for sale securities | 116,167 | Realized gain on securities |
| | 4,453 | Income tax benefit |
| | $ (7,266) | Net of tax |

[1] This accumulated other comprehensive loss component is included in the computation of net periodic pension cost. See Note 10, Notes to Consolidated Financial Statements, for additional information.

[2] This accumulated other comprehensive loss component is included in the computation of net periodic benefit cost. See Note 10, Notes to Consolidated Financial Statements, for additional information.

| Details about Accumulated Other Comprehensive Loss Components | Amount Reclassified from Accumulated Other Comprehensive Loss | Affected Line Item in the Statement Where Net Income is Presented |
|---|---|---|
| **December 31, 2016** | | |
| Amortization of defined benefit pension items | | |
| Net actuarial loss | $ (79,194) [1] | |
| Amortization of supplemental executive retirement benefit items | | |
| Prior service cost | (44,484) [2] | |
| Net gain | 6,072 [2] | |
| Reclassification adjustment for gains on available for sale securities | 89,161 | Realized gain on securities |
| | 10,809 | Income tax benefit |
| | $ (17,636) | Net of tax |

[1] This accumulated other comprehensive loss component is included in the computation of net periodic pension cost. See Note 10, Notes to Consolidated Financial Statements, for additional information.

[2] This accumulated other comprehensive loss component is included in the computation of net periodic benefit cost. See Note 10, Notes to Consolidated Financial Statements, for additional information.

## NOTE 17 – CONCENTRATION RISK

The Bank maintains its cash accounts in several correspondent banks. As of December 31, 2017, cash balances in excess of amounts insured by the Federal Deposit Insurance Corporation (FDIC) were $47,470. Most of the Bank's activities are with customers located within its local market areas. As of December 31, 2017, the Bank had two deposit relationships totaling $53,467,947 with each relationship holding more than 5% of total deposits. Significant changes in these accounts are monitored on an ongoing basis. As of December 31, 2017, real estate loans represented 94.6% of the loan portfolio. A detailed schedule is provided in Note 4, Notes to Consolidated Financial Statements. The Bank does not have any significant concentrations to any one customer.

## NOTE 18 – SUBSEQUENT EVENTS

The Bank evaluated subsequent events that have occurred after the balance sheet date, but before the consolidated financial statements are issued. There are two types of subsequent events (1) recognized, or those that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements, and (2) nonrecognized, or those that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date.

Subsequent events have been considered through March 21, 2018, the date the financial statements were available to be issued. Based on the evaluation, the Bank did not identify any recognized or nonrecognized subsequent events that would have required adjustment to or disclosure in the consolidated financial statements.