



# Bank of Botetourt

*2022 Annual Report*

**Independent Auditor's Report**

To the Board of Directors  
Bank of Botetourt  
Buchanan, Virginia

**Opinion**

We have audited the consolidated financial statements of Bank of Botetourt and subsidiary, which comprise the consolidated balance sheets as of December 31, 2022 and 2021, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of Bank of Botetourt and subsidiary as of December 31, 2022 and 2021, 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.

**Basis for Opinion**

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are required to be independent of Bank of Botetourt and subsidiary and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

**Responsibilities of Management for the Consolidated Financial Statements**

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error. In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about Bank of Botetourt and subsidiary's ability to continue as a going concern for one year from the date that the consolidated financial statements are available to be issued.

**Auditor's Responsibilities for the Audit of the Consolidated Financial Statements**

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users made on the basis of these consolidated financial statements.

**Auditor's Responsibilities for the Audit of the Consolidated Financial Statements (continued)**

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements.
- Obtain an understanding of internal control relevant to the audit 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 Bank of Botetourt and subsidiary's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about Bank of Botetourt and subsidiary's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

*Campbell & Lineberry, PC*

Roanoke, Virginia  
February 21, 2023

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## Consolidated Balance Sheets

December 31, 2022 and 2021

|                                                                                                                                                                               | <u>2022</u>           | <u>2021</u>           |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------|-----------------------|
| <b>Assets</b>                                                                                                                                                                 |                       |                       |
| Cash and due from banks                                                                                                                                                       | \$ 8,987,045          | \$ 6,987,752          |
| Interest-bearing deposits with banks                                                                                                                                          | 91,418,142            | 135,690,322           |
| Federal funds sold                                                                                                                                                            | <u>523,000</u>        | <u>445,000</u>        |
| Total cash and cash equivalents                                                                                                                                               | 100,928,187           | 143,123,074           |
| Time deposits with banks                                                                                                                                                      | 250,000               | 250,000               |
| Debt securities held-to-maturity                                                                                                                                              | 9,950,000             | 8,950,000             |
| Debt securities available for sale                                                                                                                                            | 92,551,746            | 57,529,989            |
| Restricted equity securities                                                                                                                                                  | 412,000               | 561,400               |
| Loans held for sale                                                                                                                                                           | 177,030               | 408,733               |
| Loans, net of allowance for loan losses of<br>\$6,686,450 at December 31, 2022 and \$5,674,394 in 2021                                                                        | 482,162,422           | 425,898,596           |
| Property and equipment, net                                                                                                                                                   | 14,062,939            | 14,369,040            |
| Bank owned life insurance                                                                                                                                                     | 4,313,206             | 4,401,245             |
| Accrued income                                                                                                                                                                | 1,827,578             | 1,372,291             |
| Foreclosed assets                                                                                                                                                             | -                     | 27,050                |
| Other assets                                                                                                                                                                  | <u>7,082,586</u>      | <u>5,338,223</u>      |
| Total assets                                                                                                                                                                  | <u>\$ 713,717,694</u> | <u>\$ 662,229,641</u> |
| <b>Liabilities and Stockholders' Equity</b>                                                                                                                                   |                       |                       |
| <b>Liabilities</b>                                                                                                                                                            |                       |                       |
| Noninterest-bearing deposits                                                                                                                                                  | \$ 169,162,027        | \$ 84,086,582         |
| Interest-bearing deposits                                                                                                                                                     | <u>474,761,293</u>    | <u>513,035,944</u>    |
| Total deposits                                                                                                                                                                | 643,923,320           | 597,122,526           |
| Other borrowings                                                                                                                                                              | -                     | 3,000,000             |
| Accrued interest payable                                                                                                                                                      | 324,320               | 196,677               |
| Other liabilities                                                                                                                                                             | <u>3,077,262</u>      | <u>2,773,920</u>      |
| Total liabilities                                                                                                                                                             | <u>647,324,902</u>    | <u>603,093,123</u>    |
| Commitments and contingencies                                                                                                                                                 | -                     | -                     |
| <b>Stockholders' equity</b>                                                                                                                                                   |                       |                       |
| Preferred stock, \$1.00 par value; 500,000 shares authorized<br>non-cumulative perpetual; 243,659 and 0 issued and outstanding<br>at December 31, 2022 and 2021, respectively | 243,659               | -                     |
| Common stock, \$1.50 par value; 2,500,000 shares authorized;<br>1,940,879 and 1,921,995 shares issued and outstanding<br>at December 31, 2022 and 2021, respectively          | 2,911,319             | 2,882,993             |
| Additional paid-in capital                                                                                                                                                    | 23,654,683            | 16,778,583            |
| Retained earnings                                                                                                                                                             | 47,681,356            | 41,304,253            |
| Accumulated other comprehensive loss                                                                                                                                          | <u>(8,098,225)</u>    | <u>(1,829,311)</u>    |
| Total stockholders' equity                                                                                                                                                    | <u>66,392,792</u>     | <u>59,136,518</u>     |
| Total liabilities and stockholders' equity                                                                                                                                    | <u>\$ 713,717,694</u> | <u>\$ 662,229,641</u> |

# Consolidated Statements of Income

Years ended December 31, 2022 and 2021

|                                                                | <u>2022</u>         | <u>2021</u>         |
|----------------------------------------------------------------|---------------------|---------------------|
| <b>Interest income</b>                                         |                     |                     |
| Loans and fees on loans                                        | \$ 22,030,591       | \$ 21,724,454       |
| Federal funds sold                                             | 5,115               | 141                 |
| Securities:                                                    |                     |                     |
| Taxable                                                        | 1,549,216           | 560,161             |
| Exempt from federal income tax                                 | 123,662             | -                   |
| Dividend income                                                | 19,456              | 22,536              |
| Deposits with banks                                            | <u>2,039,316</u>    | <u>164,015</u>      |
| Total interest income                                          | <u>25,767,356</u>   | <u>22,471,307</u>   |
| <b>Interest expense</b>                                        |                     |                     |
| Deposits                                                       | 2,292,486           | 2,555,955           |
| Federal funds purchased                                        | 10                  | 2                   |
| Other borrowings                                               | <u>19,623</u>       | <u>69,234</u>       |
| Total interest expense                                         | <u>2,312,119</u>    | <u>2,625,191</u>    |
| Net interest income                                            | 23,455,237          | 19,846,116          |
| <b>Provision for loan losses</b>                               | <u>1,510,000</u>    | <u>425,000</u>      |
| Net interest income after provision for loan losses            | <u>21,945,237</u>   | <u>19,421,116</u>   |
| <b>Noninterest income</b>                                      |                     |                     |
| Service charges on deposit accounts                            | 987,043             | 713,269             |
| ATM and debit card                                             | 1,711,450           | 1,604,889           |
| Other service charges and fees                                 | 681,572             | 493,546             |
| Mortgage origination fees                                      | 391,666             | 1,148,106           |
| Other income                                                   | <u>1,389,699</u>    | <u>1,354,391</u>    |
| Total noninterest income                                       | <u>5,161,430</u>    | <u>5,314,201</u>    |
| <b>Noninterest expense</b>                                     |                     |                     |
| Salaries and employee benefits                                 | 8,031,792           | 7,276,058           |
| Occupancy                                                      | 983,054             | 867,045             |
| Equipment                                                      | 883,389             | 816,588             |
| Foreclosed assets, net                                         | (15,825)            | 702,239             |
| Outside services                                               | 2,070,348           | 1,838,419           |
| FDIC insurance premiums and assessment                         | 341,069             | 332,300             |
| ATM and debit card                                             | 1,108,296           | 956,868             |
| Franchise tax                                                  | 495,728             | 437,488             |
| Telephone and communication                                    | 291,899             | 262,570             |
| Other professional fees                                        | 209,617             | 234,897             |
| Marketing                                                      | 771,528             | 617,530             |
| Other operating expenses                                       | <u>2,140,462</u>    | <u>1,825,965</u>    |
| Total noninterest expense                                      | <u>17,311,357</u>   | <u>16,167,967</u>   |
| Income before income taxes                                     | 9,795,310           | 8,567,350           |
| <b>Income tax expense</b>                                      | <u>1,989,851</u>    | <u>1,687,918</u>    |
| Net income                                                     | <u>\$ 7,805,459</u> | <u>\$ 6,879,432</u> |
| <b>Basic earnings per share<sup>1</sup></b>                    | <u>\$ 4.04</u>      | <u>\$ 3.58</u>      |
| <b>Diluted earnings per share<sup>1</sup></b>                  | <u>\$ 4.04</u>      | <u>\$ 3.58</u>      |
| <b>Basic weighted average shares outstanding<sup>1</sup></b>   | <u>1,932,448</u>    | <u>1,921,203</u>    |
| <b>Diluted weighted average shares outstanding<sup>1</sup></b> | <u>1,932,448</u>    | <u>1,921,203</u>    |

<sup>1</sup> All share and per share amounts for 2021 have been restated to reflect the ten percent stock dividend paid December 17, 2021 to shareholders of record November 30, 2021.

# Consolidated Statements of Comprehensive Income

Years ended December 31, 2022 and 2021

|                                                                                     | <u>2022</u>         | <u>2021</u>         |
|-------------------------------------------------------------------------------------|---------------------|---------------------|
| <b>Net income</b>                                                                   | \$ 7,805,459        | \$ 6,879,432        |
| <b>Other comprehensive income (loss):</b>                                           |                     |                     |
| Unrealized holding loss on debt securities available for sale                       | (7,650,362)         | (1,254,585)         |
| Tax benefit related to unrealized holding losses on securities - available for sale | 1,606,576           | 263,463             |
| Pension plan adjustment                                                             | (314,659)           | 227,691             |
| Tax benefit (expense) related to pension plan adjustment                            | 66,078              | (47,815)            |
| Post-retirement health plan adjustment                                              | 29,687              | 14,025              |
| Tax expense related to post-retirement health plan adjustment                       | (6,234)             | (2,945)             |
| Total other comprehensive loss                                                      | <u>(6,268,914)</u>  | <u>(800,166)</u>    |
| <b>Total comprehensive income</b>                                                   | <u>\$ 1,536,545</u> | <u>\$ 6,079,266</u> |

## Consolidated Statements of Stockholders' Equity

Years ended December 31, 2022 and 2021

|                                                    | Preferred<br>Stock | Common<br>Stock     | Paid-In<br>Capital   | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Total                |
|----------------------------------------------------|--------------------|---------------------|----------------------|----------------------|-----------------------------------------------------------|----------------------|
| <b>Balance, December 31, 2020</b>                  | \$ -               | \$ 2,594,820        | \$ 11,569,636        | \$ 40,680,984        | \$ (1,029,145)                                            | \$ 53,816,295        |
| Net income                                         | -                  | -                   | -                    | 6,879,432            | -                                                         | 6,879,432            |
| Changes in other comprehensive loss                | -                  | -                   | -                    | -                    | (800,166)                                                 | (800,166)            |
| Total comprehensive income                         | -                  | -                   | -                    | -                    | -                                                         | 6,079,266            |
| Cash dividends declared                            | -                  | -                   | -                    | (1,257,366)          | -                                                         | (1,257,366)          |
| Stock dividend declared                            | -                  | 261,809             | 4,736,988            | (4,998,797)          | -                                                         | -                    |
| Stock issued under Dividend Reinvest-<br>ment Plan | -                  | 26,364              | 471,959              | -                    | -                                                         | 498,323              |
| <b>Balance, December 31, 2021</b>                  | -                  | 2,882,993           | 16,778,583           | 41,304,253           | (1,829,311)                                               | 59,136,518           |
| Net income                                         | -                  | -                   | -                    | 7,805,459            | -                                                         | 7,805,459            |
| Changes in other comprehensive loss                | -                  | -                   | -                    | -                    | (6,268,914)                                               | (6,268,914)          |
| Total comprehensive income                         | -                  | -                   | -                    | -                    | -                                                         | 1,536,545            |
| Preferred stock issued, net                        | 243,659            | -                   | 6,398,602            | -                    | -                                                         | 6,642,261            |
| Cash dividends declared                            | -                  | -                   | -                    | (1,428,356)          | -                                                         | (1,428,356)          |
| Stock issued under Dividend Reinvest-<br>ment Plan | -                  | 28,326              | 477,498              | -                    | -                                                         | 505,824              |
| <b>Balance, December 31, 2022</b>                  | <u>243,659</u>     | <u>\$ 2,911,319</u> | <u>\$ 23,654,683</u> | <u>\$ 47,681,356</u> | <u>\$ (8,098,225)</u>                                     | <u>\$ 66,392,792</u> |

# Consolidated Statements of Cash Flows

Years ended December 31, 2022 and 2021

|                                                                         | <u>2022</u>           | <u>2021</u>           |
|-------------------------------------------------------------------------|-----------------------|-----------------------|
| <b><i>Cash flows from operating activities</i></b>                      |                       |                       |
| Net income                                                              | \$ 7,805,459          | \$ 6,879,432          |
| Adjustments to reconcile net income to net cash provided by operations: |                       |                       |
| Depreciation and amortization                                           | 1,010,288             | 940,243               |
| Net amortization (accretion) of securities premiums                     | (23,708)              | 23,966                |
| Provision for loan losses                                               | 1,510,000             | 425,000               |
| Deferred income tax expense                                             | 125,038               | 148,308               |
| Net realized loss (gain) on sales of assets                             | (67,605)              | 305,058               |
| Net write downs of foreclosed assets                                    | -                     | 335,000               |
| Increase in cash surrender value of life insurance                      | (78,628)              | (75,287)              |
| Gain on redemption of bank owned life insurance                         | -                     | (118,979)             |
| Changes in assets and liabilities:                                      |                       |                       |
| Loans held for sale                                                     | 231,703               | 277,212               |
| Accrued income                                                          | (455,287)             | (37,529)              |
| Other assets                                                            | (306,614)             | (1,297,586)           |
| Accrued interest payable                                                | 127,643               | (233,764)             |
| Other liabilities                                                       | <u>18,371</u>         | <u>478,070</u>        |
| Net cash provided by operating activities                               | <u>9,896,660</u>      | <u>8,049,144</u>      |
| <b><i>Cash flows from investing activities</i></b>                      |                       |                       |
| Purchases of debt securities – available for sale                       | (44,678,535)          | (49,308,064)          |
| Purchases of debt securities – held to maturity                         | (1,000,000)           | (5,900,000)           |
| Purchases of restricted equity securities                               | (63,100)              | -                     |
| Maturities of debt securities – available for sale                      | 1,145,000             | 3,305,556             |
| Proceeds from mortgage-backed securities paydowns                       | 885,124               | -                     |
| Proceeds from sale of debt securities – available for sale              | -                     | 963,750               |
| Proceeds from sale of equity securities                                 | -                     | 77,051                |
| Redemption of restricted equity securities                              | 212,500               | 144,700               |
| Purchase of bank owned life insurance                                   | -                     | (1,000,000)           |
| Redemption of bank owned life insurance                                 | 166,667               | 265,813               |
| Net decrease (increase) in loans                                        | (57,773,826)          | 29,188,144            |
| Purchases of property and equipment                                     | (613,060)             | (1,800,037)           |
| Proceeds from sales of property and equipment                           | 59,028                | -                     |
| Proceeds from sales of foreclosed assets                                | <u>48,132</u>         | <u>414,128</u>        |
| Net cash used in investing activities                                   | <u>(101,612,070)</u>  | <u>(23,648,959)</u>   |
| <b><i>Cash flows from financing activities</i></b>                      |                       |                       |
| Net increase in noninterest-bearing deposits                            | 85,075,445            | 19,379,092            |
| Net increase (decrease) in interest-bearing deposits                    | (38,274,651)          | 42,195,979            |
| Net decrease in other borrowings                                        | (3,000,000)           | (1,000,000)           |
| Proceeds from preferred stock issued                                    | 6,642,261             | -                     |
| Proceeds from common stock issued                                       | 505,824               | 498,323               |
| Dividends paid                                                          | <u>(1,428,356)</u>    | <u>(1,257,366)</u>    |
| Net cash provided by financing activities                               | <u>49,520,523</u>     | <u>59,816,028</u>     |
| Net increase in cash and cash equivalents                               | (42,194,887)          | 44,216,213            |
| <b><i>Cash and cash equivalents, beginning</i></b>                      | <u>143,123,074</u>    | <u>98,906,861</u>     |
| <b><i>Cash and cash equivalents, ending</i></b>                         | <u>\$ 100,928,187</u> | <u>\$ 143,123,074</u> |
| <b><i>Supplemental disclosure of cash flow information:</i></b>         |                       |                       |
| Interest paid                                                           | \$ 2,184,476          | \$ 2,858,955          |
| Taxes paid                                                              | <u>\$ 1,683,500</u>   | <u>\$ 2,365,000</u>   |
| <b><i>Supplemental disclosure of noncash activities:</i></b>            |                       |                       |
| Foreclosed assets acquired in settlement of loans                       | \$ -                  | \$ 27,050             |
| Loans originated to finance the sale of foreclosed assets               | \$ -                  | \$ 873,600            |
| Transfer of securities from available-for-sale to held-to-maturity      | \$ -                  | \$ 3,050,000          |
| Stock dividend declared                                                 | <u>\$ -</u>           | <u>\$ 4,998,797</u>   |

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## Notes to Consolidated Financial Statements

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### Note 1. Organization and Summary of Significant Accounting Policies

#### *Organization*

Bank of Botetourt (the “Bank”) is a Virginia state-chartered bank subject to regulation by the Virginia Bureau of Financial Institutions and the Federal Deposit Insurance Corporation. The Bank provides full banking services through thirteen branch offices in Botetourt, Roanoke, Rockbridge, and Franklin counties, the City of Salem, and the Town of Vinton, all in Virginia. The Bank uses two “trading as” names, registered with the State Corporation Commission, for market branding purposes. Virginia Mountain Mortgage is advertised for secondary market mortgage banking activities and Botetourt Wealth Management is advertised for non-FDIC insured investment products. The Bank has a wholly-owned subsidiary, Buchanan Service Corporation, which conducts its operations through an interest in an insurance company and two title insurance companies.

The accounting and reporting policies of the Bank and Buchanan Service Corporation follow generally accepted accounting principles (“GAAP”) and general practices of the financial services industry, within the Financial Accounting Standards Board’s (“FASB”) Accounting Standards Codification (“ASC”) structure of authoritative literature. Following is a summary of the more significant policies.

#### *Critical Accounting Policy*

Management believes the policy with respect to the methodology for the determination of the allowance for loan losses involves a high degree of complexity. Management must make difficult and subjective judgments which often require assumptions or estimates about highly uncertain matters. Changes in these judgments, assumptions or estimates could cause reported results to differ materially. This critical policy and its application are periodically reviewed with the Audit Committee and Board of Directors.

#### *Principles of Consolidation*

The consolidated financial statements include the accounts of the Bank and Buchanan Service Corporation. All significant intercompany transactions and balances have been eliminated in consolidation.

#### *Business Segments*

The Bank reports its activities as a single business segment. In determining proper segment definition, the Bank considers the materiality of a potential segment and components of the business about which financial information is available and regularly evaluated, relative to resource allocation and performance assessment.

#### *Cash and Cash Equivalents*

For the purpose of presentation in the Consolidated Statements of Cash Flows, cash and cash equivalents are defined as those amounts included in the balance sheet captions “Cash and due from banks”, “Interest-bearing deposits with banks”, and “Federal funds sold”.

#### *Use of Estimates*

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions in the application of certain accounting policies that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses, the valuation of other real estate acquired in connection with foreclosures or in satisfaction of loans, and employee benefit plans. In connection with the determination of the allowance for loan losses and valuation of other real estate owned, management obtains independent appraisals for significant properties.

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## Notes to Consolidated Financial Statements

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### Note 1. Organization and Summary of Significant Accounting Policies, continued

#### *Use of Estimates, continued*

The majority of the Bank's loan portfolio consists of loans in Botetourt and the adjacent counties of Southwest Virginia. Accordingly, the ultimate collectability of a substantial portion of the Bank's loan portfolio and the recovery of a substantial portion of the carrying amount of foreclosed real estate are susceptible to changes in local market conditions.

While management uses available information to recognize loan losses and losses on foreclosed real estate, future additions to the allowance for loan losses and losses on foreclosed real estate may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as part of their routine examinations process, periodically review the Bank's allowance for loan losses and the valuation of foreclosed real estate. Such agencies may require additions to the allowance for loan losses and foreclosed real estate losses based on their judgments about information available to them at the time of their examinations. Because of these factors, it is reasonably possible that the allowance for loan losses and the valuation of foreclosed real estate may change materially in the near term.

#### *Interest-bearing Deposits with Banks*

Interest-bearing deposits with banks are carried at cost.

#### *Trading Securities*

The Bank does not hold securities for short-term resale and therefore does not maintain a trading securities portfolio.

#### *Debt Securities*

Debt securities that management has the positive intent and ability to hold to maturity are classified as held to maturity and recorded at amortized cost. Securities not classified as held to maturity or trading, including equity securities with readily determinable fair values, are classified as available for sale. Securities classified as "available for sale" are recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income. Under the amended Financial Instruments topic of the Accounting Standards Codification, equity securities with readily determinable fair values are recorded at fair value with the unrealized gains and losses included in earnings. Realized gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities.

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

#### *Bank Owned Life Insurance*

The cash surrender value of bank owned life insurance is a reasonable estimate of fair value and is included in with the bank owned life insurance balance on the consolidated balance sheet. The cash surrender value of these policies was \$4,313,206 and \$4,401,245 as of December 31, 2022 and 2021, respectively. Any increase in cash surrender value is recorded as other income on the consolidated statement of income. In the event of a qualifying death of an insured individual, the Bank would receive the death benefit which would be recorded as other income.

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## Notes to Consolidated Financial Statements

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### Note 1. Organization and Summary of Significant Accounting Policies, continued

#### *Loans Held for Sale*

The carrying amount of loans originated and intended for sale in the secondary market are at fair value.

#### *Loans Receivable*

Loans receivable that management has the intent and ability to hold for the foreseeable future, or until maturity or pay-off, are reported at their outstanding principal amount adjusted for charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans.

Loan origination fees and certain direct origination costs are capitalized and recognized as an adjustment to the yield on the related loan.

Interest is accrued and credited to income based on the principal amount outstanding. The accrual of interest on impaired loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due. Management also considers the adequacy of collateral and the state of the collection process. When interest accrual is discontinued, all unpaid accrued interest is reversed. The Bank applies payments received on nonaccrual loans first to outstanding principal, and the residual amount, if any, is applied to interest. When facts, circumstances, and consistent performance indicate the borrower has regained the ability to meet required payments, the loan is returned to accrual status. Past due status of loans is determined based on contractual terms.

#### *Allowance for Loan Losses*

The allowance for loan losses is an estimate of the losses that may be sustained in the loan portfolio and is based on accounting standards for contingencies and receivables. The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the loan balance is uncollectible. Subsequent recoveries, if any, are credited to the allowance. The allowance for loan losses consists of specific, general and unallocated components and is evaluated on a regular basis by management.

#### *Property and Equipment*

Land is carried at cost. Buildings and furniture and equipment are carried at cost, less accumulated depreciation and amortization computed principally by the straight-line method over the following estimated useful lives or lease terms:

|                            | <u>Years</u> |
|----------------------------|--------------|
| Buildings and improvements | 7-40         |
| Furniture and equipment    | 3-10         |

#### *Foreclosed Assets*

Real estate properties acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at the lower of loan balance or fair value less the cost to sell at the date of foreclosure, 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 during the holding period, gains and losses on sale, and changes in the valuation allowance are included in net expenses from foreclosed assets.

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## Notes to Consolidated Financial Statements

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### **Note 1. Organization and Summary of Significant Accounting Policies, continued**

#### ***Employee Benefit Plans***

A noncontributory cash balance pension plan (the “Plan”) has been provided for all employees who met the eligibility requirements of 21 years of age and one year of service. The formulary contribution allocated annually to each participant’s hypothetical cash balance account is based on the ages and years of service of the employee participants. Interest credit is indexed to the 10-year Treasury rate and is guaranteed not to be less than 3% on an annual basis. To maintain the Plan’s funding adequacy, the Bank contributes an appropriate amount which is deductible for federal income tax purposes. Benefits under the Plan are accrued by periodic charges to income as determined by the Plan’s actuaries. To the extent accumulated Plan assets, including current period cash contributions, are less than projected benefit obligations, the Bank accrues such obligations through either a charge to income or other comprehensive income. To the extent accumulated Plan assets are greater than projected benefit obligations, the Bank records such benefits as a reduction of expense or as other comprehensive income. The Bank has adopted the amended Compensation – Retirement Benefits topic of the Accounting Standards Codification related to the income statement presentation of the components of net periodic benefit cost of the Plan. Adoption of the amendment had an immaterial effect on the Bank’s income statement.

The Bank also provides a qualified profit sharing/thrift plan. All eligible employees, age 18 and older, are automatically enrolled to participate, unless they choose to opt-out of the plan, after completing their first six months of service. The Bank expenses its matching portion to the employees’ contributions each payroll period.

The Bank sponsors a post-retirement health care plan for certain retired employees. Expenses related to benefits under the plan are shared by the Bank and the retirees monthly. The Bank’s monthly portion is expensed to income. To the extent accumulated plan assets, including periodic cash contributions from the Bank and the retirees, are less than the benefit obligations, the Bank accounts for such obligations through either a charge to income or other comprehensive income.

#### ***Marketing, Advertising and Public Relations Expense***

The Bank expenses marketing, advertising and public relations costs as they are incurred.

#### ***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, (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.

#### ***Income Taxes***

Provision for income taxes is based on amounts reported in the consolidated statements of income (after exclusion of non-taxable income such as interest on state and municipal securities and loans) and consists of taxes currently due plus deferred taxes on temporary differences in the recognition of income and expense for tax and financial statement purposes. Deferred tax assets and liabilities are included in the financial statements at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

Deferred income tax liabilities relating to unrealized appreciation (or the deferred tax asset in the case of unrealized depreciation) on investment debt securities available for sale and the pension plan and post-retirement benefits are recorded in other liabilities (assets). These items are recorded as an adjustment to equity and to other comprehensive income in the financial statements and not included in net income determination until realized. Accordingly, the resulting deferred income tax liabilities or assets are also recorded as an adjustment to equity and to other comprehensive income.

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## Notes to Consolidated Financial Statements

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### **Note 1. Organization and Summary of Significant Accounting Policies, continued**

#### ***Income Taxes, continued***

The Bank defers loan fees and costs for financial statement purposes. Current tax regulations suggest that loan fees also be deferred using the effective yield method for income tax purposes. These regulations also suggest that the associated costs, which are primarily employee salaries, be currently deducted. The Bank has chosen to accelerate revenue recognition by including these loan fees in current year income for income tax purposes. As a result of the implementation of disclosure guidance regarding Income Taxes, the Bank has not incurred a tax benefit because the payment of tax on these fees has been accelerated.

In the event that the Bank has an unrecognized tax benefit in future accounting periods, the Bank will recognize interest accrued related to the benefit in interest expense and penalties in operating expenses. There were no interest or penalties related to an unrecognized tax benefit for the years ended December 31, 2022 and 2021. Because of the impact of deferred tax accounting, other than interest and penalties, the reversal of the above treatment by taxing authorities would not affect the annual effective tax rate but would defer the payment of cash to the taxing authority to later periods.

#### ***Basic and Diluted Earnings per Share***

Basic and diluted earnings per share is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding during the period. At December 31, 2022 and 2021, the Bank had no potentially dilutive securities outstanding. All per share amounts for the fiscal year 2021 has been restated to reflect the ten percent stock dividend paid on December 17, 2021.

#### ***Comprehensive Income (Loss)***

Comprehensive income (loss) reflects the change in the Bank's equity during the year arising from transactions and events other than investments by, and distributions to, stockholders. It consists of net income plus certain other changes in assets and liabilities that are reported as separate components of stockholders' equity rather than as income or expense.

#### ***Financial Instruments***

In the ordinary course of business, the Bank has entered into off-balance sheet financial instruments consisting of commitments to extend credit and commercial and standby letters of credit. Such financial instruments are recorded in the financial statements when they are funded. Related fees are recorded when they are incurred or received.

#### ***Fair Value Measurements***

The Fair Value Measurements and Disclosures topic provides guidance and requires disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instruments.

#### ***Revenue Recognition***

The core principle of Revenue from Contracts with Customers is that an entity should recognize revenue to reflect the transfer of goods and services to customers in an amount equal to the consideration the entity receives or expects to receive. The scope of the guidance explicitly excludes revenue recognition from net interest income as well as many other revenue streams from financial assets and liabilities including loans, leases, and securities. Accordingly, the accounting policies for the majority of the Bank's revenues were not covered by this accounting standard. The Bank assesses its revenue contracts related to revenue streams that are within the scope of the standard and the principles of revenue recognition from the accounting standard are largely consistent with existing guidance and current practices already applied by the Bank.

# Notes to Consolidated Financial Statements

## Note 1. Organization and Summary of Significant Accounting Policies, continued

### Leases

The Bank evaluates its new and existing leasing contracts and activities under the amended Leases topic of the Accounting Standards Codification for recognition, measurement, presentation, and disclosure of leasing transactions and requires all leases with lease terms over twelve months to be capitalized as a right-of-use asset and lease liability on the balance sheet at the date of lease commencement. Leases are classified as either finance leases or operating leases. The amended Leases topic allows the Bank to largely account for the existing leases consistent with current guidance except for the incremental balance sheet recognition for any qualifying leases.

### Subsequent Events

The Bank has evaluated subsequent events for recognition and disclosure through February 21, 2023, which is the date the financial statements were available to be issued.

### Reclassification

Certain reclassifications have been made to the prior year's financial statements to place them on a comparable basis with the current year. Net income and stockholders' equity previously reported were not affected by these reclassifications.

## Note 2. Restrictions on Cash

To comply with banking regulations, the Bank is required to maintain certain average cash reserve balances. The daily average cash reserve requirement was approximately \$1,050,000 for the periods ending December 31, 2022 and 2021.

## Note 3. Securities

Debt and equity securities have been classified in the consolidated balance sheets according to management's intent. The carrying amounts of securities and their approximate fair values at December 31 follow:

|                                  | <u>Amortized<br/>Cost</u> | <u>Unrealized<br/>Gains</u> | <u>Unrealized<br/>Losses</u> | <u>Fair<br/>Value</u> |
|----------------------------------|---------------------------|-----------------------------|------------------------------|-----------------------|
| <b><u>2022</u></b>               |                           |                             |                              |                       |
| <i>Available for sale:</i>       |                           |                             |                              |                       |
| Government-sponsored enterprises | \$ 54,424,647             | \$ -                        | \$ 5,203,035                 | \$ 49,221,612         |
| State and municipal securities   | 19,885,714                | -                           | 2,361,030                    | 17,524,684            |
| U.S. treasury securities         | 14,896,527                | -                           | 418,997                      | 14,477,530            |
| Mortgaged-backed securities      | 11,058,204                | -                           | 567,624                      | 10,490,580            |
| Corporate securities             | <u>1,003,811</u>          | <u>-</u>                    | <u>166,471</u>               | <u>837,340</u>        |
|                                  | <u>\$ 101,268,903</u>     | <u>\$ -</u>                 | <u>\$ 8,717,157</u>          | <u>\$ 92,551,746</u>  |
| <b><u>2021</u></b>               |                           |                             |                              |                       |
| <i>Available for sale:</i>       |                           |                             |                              |                       |
| Government-sponsored enterprises | \$ 47,443,743             | \$ 703                      | \$ 1,028,065                 | \$ 46,416,381         |
| State and municipal securities   | 10,655,708                | 76,372                      | 105,867                      | 10,626,213            |
| Corporate securities             | <u>497,333</u>            | <u>-</u>                    | <u>9,938</u>                 | <u>487,395</u>        |
|                                  | <u>\$ 58,596,784</u>      | <u>\$ 77,075</u>            | <u>\$ 1,143,870</u>          | <u>\$ 57,529,989</u>  |

Government-sponsored enterprises, commonly referred to as U.S. Government Agencies, include investments in Federal Farm Credit Banks, Federal Home Loan Banks, and Federal Home Loan Mortgage Corporation.

All mortgage-backed securities included in the above table were by U.S. Government Agencies.

## Notes to Consolidated Financial Statements

### Note 3. Securities, continued

Debt securities held to maturity consisted of an investment in subordinated debt offerings of a 501(c)(3) non-profit, non-stock Community Development Financial Institution (“CDFI”) dedicated to revitalizing communities, facilitating the creation of jobs, and increasing the amount of affordable housing throughout Virginia and investments in subordinated debt offerings of for-profit commercial financial institutions. The amortized cost and carrying value of these securities was \$9,950,000 as of December 31, 2022 and \$8,950,000 as of December 31, 2021.

No investment securities were pledged at December 31, 2022 and 2021.

Gains and losses on the sale of investment securities are determined using the specific identification method. During 2022, there were no sales of investment securities. During 2021, proceeds from the sale of investment securities, including an equity security, amounted to \$1,040,801 with gross realized gains amounting to \$43,760.

The scheduled maturities of securities available for sale and held to maturity at December 31, 2022, are shown below. Actual expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations. Mortgaged-back securities included in these totals are categorized by final maturity at December 31, 2022.

|                                        | <u>Available for Sale</u> |                      | <u>Held to Maturity</u> |
|----------------------------------------|---------------------------|----------------------|-------------------------|
|                                        | <u>Amortized Cost</u>     | <u>Fair Value</u>    | <u>Amortized Cost</u>   |
| Due in one year or less                | \$ 7,941,972              | \$ 7,808,662         | \$ 250,000              |
| Due after one year through five years  | 66,993,493                | 61,021,222           | 150,000                 |
| Due after five years through ten years | 23,563,103                | 21,291,940           | 9,550,000               |
| Due after ten years                    | 2,770,335                 | 2,429,922            | -                       |
|                                        | <u>\$ 101,268,903</u>     | <u>\$ 92,551,746</u> | <u>\$ 9,950,000</u>     |

The following tables detail unrealized losses and related fair values in the Bank’s investment securities portfolio. This information is aggregated by the length of time that individual securities have been in a continuous unrealized loss position as of December 31.

|                                       | <u>Less Than 12 Months</u> |                          | <u>12 Months or More</u> |                          | <u>Total</u>        |                          |
|---------------------------------------|----------------------------|--------------------------|--------------------------|--------------------------|---------------------|--------------------------|
|                                       | <u>Fair Value</u>          | <u>Unrealized Losses</u> | <u>Fair Value</u>        | <u>Unrealized Losses</u> | <u>Fair Value</u>   | <u>Unrealized Losses</u> |
| <b>2022</b>                           |                            |                          |                          |                          |                     |                          |
| Government-sponsored enterprises      | \$ 6,546,910               | \$ 434,676               | \$42,674,702             | \$ 4,768,359             | \$49,221,612        | \$ 5,203,035             |
| State and municipal securities        | 10,778,946                 | 1,103,169                | 6,745,738                | 1,257,861                | 17,524,684          | 2,361,030                |
| U.S. treasury securities              | 14,477,530                 | 418,997                  | -                        | -                        | 14,477,530          | 418,997                  |
| Mortgaged-backed securities           | 10,490,580                 | 567,624                  | -                        | -                        | 10,490,580          | 567,624                  |
| Corporate securities                  | 426,680                    | 79,173                   | 410,660                  | 87,298                   | 837,340             | 166,471                  |
| Total temporarily impaired securities | <u>\$42,720,646</u>        | <u>\$ 2,603,639</u>      | <u>\$49,831,100</u>      | <u>\$ 6,113,518</u>      | <u>\$92,551,746</u> | <u>\$ 8,717,157</u>      |
| <b>2021</b>                           |                            |                          |                          |                          |                     |                          |
| Government-sponsored enterprises      | \$44,415,678               | \$ 1,028,065             | \$ 1,467,338             | \$ 32,662                | \$45,883,016        | \$ 1,060,727             |
| State and municipal securities        | 6,957,028                  | 105,867                  | -                        | -                        | 6,957,028           | 105,867                  |
| Corporate securities                  | 487,395                    | 9,938                    | -                        | -                        | 487,395             | 9,938                    |
| Total temporarily impaired securities | <u>\$51,860,101</u>        | <u>\$ 1,143,870</u>      | <u>\$ 1,467,338</u>      | <u>\$ 32,662</u>         | <u>\$53,327,439</u> | <u>\$ 1,176,532</u>      |

Management considers the nature of the investment, the underlying causes of the decline in market value, the severity and duration of the decline in market value and other evidence, on a security by security basis, in determining if the decline in market value is other than temporary. The Bank does not believe that gross unrealized losses as of December 31, 2022, which is comprised of one hundred eighteen investment securities, represent an other-than-temporary impairment. The gross unrealized losses reported relate to investment securities in all categories. Total gross unrealized losses, which represent 8.61% of the amortized cost basis of the Bank’s total investment securities, were attributable to changes in interest rates due to market conditions and not due to the credit quality of the investment securities. The

## Notes to Consolidated Financial Statements

### Note 3. Securities, continued

Bank has both the ability and the intent to hold all of these securities for a period of time necessary to recover amortized cost.

Restricted equity securities of \$412,000 in 2022 and \$561,400 in 2021, which are carried at cost, consist of investments in stock of the Federal Home Loan Bank of Atlanta (“FHLB”), and CBB Financial Corp., which are upstream correspondents of the Bank. The FHLB requires financial institutions to make equity investments in the FHLB in order to borrow from it. The Bank is required to hold that stock so long as it has borrowing capacity from the FHLB. Both the Bank’s stock in CBB Financial Corp. and the FHLB are restricted in the fact that the stock may only be repurchased by the issuer. Management also considers these investments when testing for impairment. On a quarterly basis, management reviews both institutions’ capital adequacy to ensure they meet regulatory minimum requirements. Bank management does not believe any unrealized losses associated with investments in these institutions to be anything other than temporary.

### Note 4. Loans Receivable

The Bank segments its loan portfolio to capture the nature of credit risk inherent in its loans receivable. These segments allow management to monitor risk and performance. In reviewing risk, management has determined there to be several different risk categories within the loan portfolio. The allowance for loan losses consists of amounts applicable to portfolios of: (i) Commercial Loans; (ii) Commercial Real Estate Loans; (iii) Consumer Loans; (iv) Residential – Prime Loans; and (v) Agricultural and Raw Land Loans.

The Commercial segment consists of loans made for the purpose of financing the activities of commercial customers. The Commercial Real Estate portfolio includes owner occupied, non-owner occupied, and multi-family dwellings. The Residential – Prime Loan segment consists of fixed rate and adjustable rate single-family amortizing term loans, which are primarily first liens and home equity loans which are generally second liens. The Agricultural and Raw Land category is for farm loans and for undeveloped land. Consumer loans consist of motor vehicle loans, savings account loans, personal lines of credit, overdrafts, other types of secured consumer loans, and unsecured personal loans.

The major segmented components of loans at December 31 are as follows (in thousands):

|                           | <u>2022</u>       | <u>2021</u>       |
|---------------------------|-------------------|-------------------|
| Commercial                | \$ 38,782         | \$ 35,540         |
| Commercial Real Estate    | 170,781           | 155,109           |
| Consumer                  | 20,927            | 17,577            |
| Residential - Prime       | 232,917           | 200,772           |
| Agricultural & Raw Land   | <u>25,442</u>     | <u>22,575</u>     |
|                           | 488,849           | 431,573           |
| Allowance for loan losses | <u>(6,686)</u>    | <u>(5,674)</u>    |
|                           | <u>\$ 482,163</u> | <u>\$ 425,899</u> |

Loans receivable include \$212,000 and \$97,000 in overdraft deposit accounts at December 31, 2022 and 2021, respectively.

The Bank had no subprime residential loans at December 31, 2022 or 2021.

Construction loans are originated in the Commercial Real Estate and Residential – Prime segments of the loan portfolio, as reflected in the components in the table above. Construction lending is generally considered to involve a higher degree of credit risk than long-term permanent financing. If the estimate of construction cost proves to be inaccurate, the Bank may be compelled to advance additional funds to complete the construction with repayment dependent, in part, on the success of the ultimate project rather than the ability of a borrower or guarantor to repay the loan. If the Bank is forced to foreclose on a project prior to completion, there is no assurance that it will be able to recover all of the unpaid portion of the loan. In addition, the Bank may be required to fund additional amounts to complete a project and may have to hold the property for an indeterminate period of time. As of December 31, 2022,

## Notes to Consolidated Financial Statements

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### **Note 4. Loans Receivable, continued**

construction lending represents \$34,303,000 or 7.04% of the overall loan portfolio, compared to \$31,155,000, or 7.20%, the year prior.

The Coronavirus Aid, Relief, and Economic Security (“CARES”) Act established several new temporary U.S. Small Business Administration (“SBA”) loan programs to assist U.S. small businesses through the COVID-19 health pandemic. One such loan program was the Paycheck Protection Program (“PPP”), an expansion of the SBA’s 7(a) loan program. From 2020 to 2021, the PPP provided loans to small businesses who were affected by economic conditions as a result of COVID-19 to provide cash-flow assistance to employers who maintain their payroll (including healthcare and certain related expenses), mortgage interest, rent, leases, utilities and interest on existing debt during this emergency. Pursuant to the provisions of Section 1106 of the CARES Act, borrowers applied to the Bank for loan forgiveness of all or a portion of the loan, subject to certain eligibility requirements and conditions. The CARES Act authorized the SBA to fully guarantee these loans.

At December 31, 2021, \$6.0 million of PPP loans remained outstanding with \$460,000 of unearned fees. During 2022, all remaining PPP loans were either paid off by the borrower or approved for forgiveness or guarantee by the SBA who in turn reimbursed the Bank. Therefore the \$460,000 was recognized as revenue in 2022. No PPP loans remain at December 31, 2022.

### **Note 5. Allowance for Loan Losses**

The allowance for loan losses is an estimate of the losses that may be sustained in the loan portfolio. The allowance is based on three basic principles of accounting: (i) guidance for Contingencies, which requires that losses be accrued when they are probable of occurring and estimable, (ii) guidance for Receivables, which requires that losses be accrued based on the differences between the present value of future cash flows, value of collateral, or values that are observable in the market, and the loan balance, and (iii) guidance allowing a creditor to use existing methods for recognizing interest income on an impaired loan.

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loans identified as losses and deemed uncollectible by management are charged to the allowance. Subsequent recoveries, if any, are credited to the allowance.

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

The allowance consists of specific, general, and unallocated components. The specific component relates to loans that are classified as impaired, for which an allowance is established when the discounted cash flows, collateral value, or observable market price of the loan is lower than its carrying value. The general component covers non-impaired loans and is based on historical loss experience adjusted for qualitative factors. Historical losses are categorized into risk-similar loan pools and a loss ratio factor is applied to each group’s loan balances to determine the allocation. The loss ratio factor is based on average loss history for the current year and two prior years to ensure the most relevant data is being used in the model following the economic recession, anemic recovery, and current economic conditions.

An unallocated component is maintained to cover uncertainties that could affect management’s estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio. Qualitative environmental factors include external risk factors that management believes affect the overall lending environment of the Bank. Environmental factors that management of the Bank routinely analyze include levels and trends in delinquencies and impaired loans, levels and trends in charge-offs and recoveries, trends in volume and terms of loans, effects of changes in risk selection and underwriting practices, experience, ability, and depth of lending management and staff, national and local economic trends and conditions such as unemployment rates, housing statistics, banking

## Notes to Consolidated Financial Statements

### Note 5. Allowance for Loan Losses, continued

industry conditions, local economic forecasts, the effect of changes in credit concentrations, and an analysis of economic conditions, including inflation and other uncertainties.

The following table presents activity in the allowance for loan losses for the years-ended December 31, 2022 and 2021 on a portfolio segment basis. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

|                                          | Commercial           | Commercial<br>Real Estate | Consumer             | Residential-<br>Prime | Agricultural<br>& Raw Land | Total                 |
|------------------------------------------|----------------------|---------------------------|----------------------|-----------------------|----------------------------|-----------------------|
| <b>Allowance for loan losses:</b>        |                      |                           |                      |                       |                            |                       |
| Balance, January 1, 2022                 | \$ 425,400           | \$ 1,943,300              | \$ 482,365           | \$ 2,574,189          | \$ 249,140                 | \$ 5,674,394          |
| Charge-offs                              | (48,380)             | (106,648)                 | (409,491)            | (4,527)               | (18,213)                   | (587,259)             |
| Recoveries                               | 1,125                | -                         | 85,492               | 2,698                 | -                          | 89,315                |
| Provision for (recovery of) loan losses  | 141,805              | 436,348                   | 290,145              | 609,440               | 32,262                     | 1,510,000             |
| Balance, December 31, 2022               | <u>\$ 519,950</u>    | <u>\$ 2,273,000</u>       | <u>\$ 448,511</u>    | <u>\$ 3,181,800</u>   | <u>\$ 263,189</u>          | <u>\$ 6,686,450</u>   |
| Balance, January 1, 2021                 | \$ 536,800           | \$ 1,666,382              | \$ 336,200           | \$ 2,460,458          | \$ 238,729                 | \$ 5,238,569          |
| Charge-offs                              | -                    | (24,150)                  | (44,104)             | (41,650)              | -                          | (109,904)             |
| Recoveries                               | 5,100                | 32,096                    | 62,086               | 6,447                 | 15,000                     | 120,729               |
| Provision for (recovery of) loan losses  | (116,500)            | 268,972                   | 128,183              | 148,934               | (4,589)                    | 425,000               |
| Balance, December 31, 2021               | <u>\$ 425,400</u>    | <u>\$ 1,943,300</u>       | <u>\$ 482,365</u>    | <u>\$ 2,574,189</u>   | <u>\$ 249,140</u>          | <u>\$ 5,674,394</u>   |
|                                          | Commercial           | Commercial<br>Real Estate | Consumer             | Residential-<br>Prime | Agricultural<br>& Raw Land | Total                 |
| <b>December 31, 2022</b>                 |                      |                           |                      |                       |                            |                       |
| <b>Allowance for loan losses</b>         |                      |                           |                      |                       |                            |                       |
| <b>ending balances:</b>                  |                      |                           |                      |                       |                            |                       |
| Individually evaluated for<br>impairment | <u>\$ 11,050</u>     | <u>\$ -</u>               | <u>\$ 20,725</u>     | <u>\$ -</u>           | <u>\$ 31,189</u>           | <u>\$ 62,964</u>      |
| Collectively evaluated for<br>impairment | <u>\$ 508,900</u>    | <u>\$ 2,273,000</u>       | <u>\$ 427,786</u>    | <u>\$ 3,181,800</u>   | <u>\$ 232,000</u>          | <u>\$ 6,623,486</u>   |
| <b>Loans receivable:</b>                 |                      |                           |                      |                       |                            |                       |
| Ending balance - total                   | <u>\$ 38,782,443</u> | <u>\$ 170,780,823</u>     | <u>\$ 20,927,245</u> | <u>\$ 232,916,672</u> | <u>\$ 25,441,689</u>       | <u>\$ 488,848,872</u> |
| Ending balances:                         |                      |                           |                      |                       |                            |                       |
| Individually evaluated for<br>impairment | <u>\$ 4,513</u>      | <u>\$ 360,950</u>         | <u>\$ 20,441</u>     | <u>\$ 1,001,161</u>   | <u>\$ 228,912</u>          | <u>\$ 1,615,977</u>   |
| Collectively evaluated for<br>impairment | <u>\$ 38,777,930</u> | <u>\$ 170,419,873</u>     | <u>\$ 20,906,804</u> | <u>\$ 231,915,511</u> | <u>\$ 25,212,777</u>       | <u>\$ 487,232,895</u> |
| <b>December 31, 2021</b>                 |                      |                           |                      |                       |                            |                       |
| <b>Allowance for loan losses</b>         |                      |                           |                      |                       |                            |                       |
| <b>ending balances:</b>                  |                      |                           |                      |                       |                            |                       |
| Individually evaluated for<br>impairment | <u>\$ -</u>          | <u>\$ -</u>               | <u>\$ 197,365</u>    | <u>\$ 6,289</u>       | <u>\$ -</u>                | <u>\$ 203,654</u>     |
| Collectively evaluated for<br>impairment | <u>\$ 425,400</u>    | <u>\$ 1,943,300</u>       | <u>\$ 285,000</u>    | <u>\$ 2,567,900</u>   | <u>\$ 249,140</u>          | <u>\$ 5,470,740</u>   |
| <b>Loans receivable:</b>                 |                      |                           |                      |                       |                            |                       |
| Ending balance - total                   | <u>\$ 35,539,814</u> | <u>\$ 155,108,999</u>     | <u>\$ 17,577,300</u> | <u>\$ 200,771,585</u> | <u>\$ 22,575,292</u>       | <u>\$ 431,572,990</u> |
| Ending balances:                         |                      |                           |                      |                       |                            |                       |
| Individually evaluated for<br>impairment | <u>\$ 16,077</u>     | <u>\$ 1,027,080</u>       | <u>\$ 197,365</u>    | <u>\$ 1,440,395</u>   | <u>\$ 234,312</u>          | <u>\$ 2,915,229</u>   |
| Collectively evaluated for<br>impairment | <u>\$ 35,523,737</u> | <u>\$ 154,081,919</u>     | <u>\$ 17,379,935</u> | <u>\$ 199,331,190</u> | <u>\$ 22,340,980</u>       | <u>\$ 428,657,761</u> |

## Notes to Consolidated Financial Statements

### Note 5. Allowance for Loan Losses, continued

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 or interest when due according to the contractual terms of the loan agreement. Management assesses for possible loan impairment on a quarterly basis. The impairment review includes examining factors such as the loan balance, payment status, recent payment history, principal curtailment on lines of credit, extensions granted, risk rating, maturity date advancement, and the probability of collecting scheduled principal and interest payments when due. A loan may be considered impaired by management, and still be expected to have full repayment of both principal and interest, but not according to the contractual terms of the loan agreement. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. Large groups of smaller balance homogeneous loans are collectively evaluated for potential loss exposure. Accordingly, the Bank does not generally separately identify individual consumer and residential loans for impairment disclosures.

Cash payments received for individually evaluated impaired loans are recorded according to the accrual status of the loan. If the impaired loan is on nonaccrual status, payments are applied to the principal balance. Otherwise the payment is applied according to its contractual terms. The recorded investment is defined as the original amount of the loan, net of any deferred costs and fees, less any principal reductions and direct charge-offs. Impaired loans with a balance at the end of the period are reflected in the recorded investment and unpaid principal balance columns. The average recorded investment represents the Bank's average investment in those same loans during the period. The following tables present impaired loans in the segmented portfolio categories as of December 31:

#### 2022:

|                                            | <u>Recorded<br/>Investment</u> | <u>Unpaid<br/>Principal<br/>Balance</u> | <u>Related<br/>Allowance</u> | <u>Average<br/>Recorded<br/>Investment</u> | <u>Interest<br/>Income<br/>Recognized</u> |
|--------------------------------------------|--------------------------------|-----------------------------------------|------------------------------|--------------------------------------------|-------------------------------------------|
| <u>With no related allowance recorded:</u> |                                |                                         |                              |                                            |                                           |
| Commercial                                 | \$ 2,011                       | \$ 4,513                                | \$ -                         | \$ 7,290                                   | \$ 923                                    |
| Commercial Real Estate                     | 361,473                        | 360,950                                 | -                            | 765,698                                    | 41,690                                    |
| Residential - Prime                        | 864,689                        | 866,095                                 | -                            | 1,036,835                                  | 84,891                                    |
| Consumer                                   | -                              | -                                       | -                            | -                                          | -                                         |
| Agricultural & Raw Land                    | 227,778                        | 228,912                                 | -                            | 229,728                                    | 30,197                                    |
| <u>With an allowance recorded:</u>         |                                |                                         |                              |                                            |                                           |
| Commercial                                 | \$ -                           | \$ -                                    | \$ -                         | \$ 6,739                                   | \$ -                                      |
| Commercial Real Estate                     | -                              | -                                       | -                            | 59,046                                     | -                                         |
| Residential - Prime                        | 135,437                        | 135,066                                 | 42,239                       | 16,583                                     | 11,521                                    |
| Consumer                                   | 20,553                         | 20,441                                  | 20,725                       | 41,239                                     | 894                                       |
| Agricultural & Raw Land                    | -                              | -                                       | -                            | -                                          | -                                         |
| <u>Total:</u>                              |                                |                                         |                              |                                            |                                           |
| Commercial                                 | \$ 2,011                       | \$ 4,513                                | \$ -                         | \$ 14,029                                  | \$ 923                                    |
| Commercial Real Estate                     | 361,473                        | 360,950                                 | -                            | 824,744                                    | 41,690                                    |
| Residential - Prime                        | 1,000,126                      | 1,001,161                               | 42,239                       | 1,053,418                                  | 96,412                                    |
| Consumer                                   | 20,553                         | 20,441                                  | 20,725                       | 41,239                                     | 894                                       |
| Agricultural & Raw Land                    | 227,778                        | 228,912                                 | -                            | 229,728                                    | 30,197                                    |

## Notes to Consolidated Financial Statements

### Note 5. Allowance for Loan Losses, continued

#### 2021:

|                                            | <u>Recorded<br/>Investment</u> | <u>Unpaid<br/>Principal<br/>Balance</u> | <u>Related<br/>Allowance</u> | <u>Average<br/>Recorded<br/>Investment</u> | <u>Interest<br/>Income<br/>Recognized</u> |
|--------------------------------------------|--------------------------------|-----------------------------------------|------------------------------|--------------------------------------------|-------------------------------------------|
| <u>With no related allowance recorded:</u> |                                |                                         |                              |                                            |                                           |
| Commercial                                 | \$ 15,211                      | \$ 16,077                               | \$ -                         | \$ 25,028                                  | \$ 2,009                                  |
| Commercial Real Estate                     | 1,028,809                      | 1,027,080                               | -                            | 503,154                                    | 104,637                                   |
| Residential - Prime                        | 1,434,059                      | 1,434,385                               | -                            | 1,241,857                                  | 123,031                                   |
| Consumer                                   | -                              | -                                       | -                            | 2,028                                      | -                                         |
| Agricultural & Raw Land                    | 233,178                        | 234,312                                 | -                            | 242,674                                    | 30,267                                    |
| <u>With an allowance recorded:</u>         |                                |                                         |                              |                                            |                                           |
| Commercial                                 | \$ -                           | \$ -                                    | \$ -                         | \$ -                                       | \$ -                                      |
| Commercial Real Estate                     | -                              | -                                       | -                            | 79,010                                     | -                                         |
| Residential - Prime                        | 6,369                          | 6,010                                   | 6,289                        | 81,129                                     | 386                                       |
| Consumer                                   | 197,365                        | 197,365                                 | 197,365                      | 16,447                                     | 11,006                                    |
| Agricultural & Raw Land                    | -                              | -                                       | -                            | 11,203                                     | -                                         |
| <u>Total:</u>                              |                                |                                         |                              |                                            |                                           |
| Commercial                                 | \$ 15,211                      | \$ 16,077                               | \$ -                         | \$ 25,028                                  | \$ 2,009                                  |
| Commercial Real Estate                     | 1,028,809                      | 1,027,080                               | -                            | 582,164                                    | 104,637                                   |
| Residential - Prime                        | 1,440,428                      | 1,440,395                               | 6,289                        | 1,322,986                                  | 123,417                                   |
| Consumer                                   | 197,365                        | 197,365                                 | 197,365                      | 18,475                                     | 11,006                                    |
| Agricultural & Raw Land                    | 233,178                        | 234,312                                 | -                            | 253,877                                    | 30,267                                    |

Loans are considered past due if the required principal and interest payment have not been received as of the due date. The following schedule is an aging of past due loans receivable, including those on nonaccrual status, by portfolio segment as of December 31, 2022.

|                         | <u>30-59 Days<br/>Past Due</u> | <u>60-89 Days<br/>Past Due</u> | <u>Greater Than<br/>90 Days</u> | <u>Total<br/>Past Due</u> | <u>Current</u>        | <u>Total<br/>Loans<br/>Receivable</u> | <u>Recorded<br/>Investment &gt;<br/>90 Days and<br/>Accruing</u> |
|-------------------------|--------------------------------|--------------------------------|---------------------------------|---------------------------|-----------------------|---------------------------------------|------------------------------------------------------------------|
| Commercial              | \$ 264,614                     | \$ 100,279                     | \$ 331,343                      | \$ 696,236                | \$ 38,086,207         | \$ 38,782,443                         | \$ 327,185                                                       |
| Commercial Real Estate  | 827,046                        | 327,176                        | 34,108                          | 1,188,330                 | 169,592,493           | 170,780,823                           | 34,108                                                           |
| Consumer                | 329,212                        | 92,051                         | 56,759                          | 478,022                   | 20,449,223            | 20,927,245                            | 34,523                                                           |
| Residential - Prime     | 874,688                        | 2,160,448                      | 833,938                         | 3,869,074                 | 229,047,598           | 232,916,672                           | 218,702                                                          |
| Agricultural & Raw Land | 182,538                        | -                              | 250,836                         | 433,374                   | 25,008,315            | 25,441,689                            | 20,372                                                           |
| Total                   | <u>\$ 2,478,098</u>            | <u>\$ 2,679,954</u>            | <u>\$ 1,506,984</u>             | <u>\$ 6,665,036</u>       | <u>\$ 482,183,836</u> | <u>\$ 488,848,872</u>                 | <u>\$ 634,890</u>                                                |

The following schedule is an aging of past due loans receivable, including those on nonaccrual status, by portfolio segment as of December 31, 2021.

|                         | <u>30-59 Days<br/>Past Due</u> | <u>60-89 Days<br/>Past Due</u> | <u>Greater Than<br/>90 Days</u> | <u>Total<br/>Past Due</u> | <u>Current</u>        | <u>Total<br/>Loans<br/>Receivable</u> | <u>Recorded<br/>Investment &gt;<br/>90 Days and<br/>Accruing</u> |
|-------------------------|--------------------------------|--------------------------------|---------------------------------|---------------------------|-----------------------|---------------------------------------|------------------------------------------------------------------|
| Commercial              | \$ 176,415                     | \$ -                           | \$ 6,000                        | \$ 182,415                | \$ 35,357,399         | \$ 35,539,814                         | \$ 4,532                                                         |
| Commercial Real Estate  | -                              | -                              | 662,934                         | 662,934                   | 154,446,065           | 155,108,999                           | -                                                                |
| Consumer                | 260,146                        | 60,855                         | 240,804                         | 561,805                   | 17,015,495            | 17,577,300                            | 42,613                                                           |
| Residential - Prime     | 1,168,768                      | 337,351                        | 880,395                         | 2,386,514                 | 198,385,071           | 200,771,585                           | 618,853                                                          |
| Agricultural & Raw Land | 712,473                        | -                              | -                               | 712,473                   | 21,862,819            | 22,575,292                            | -                                                                |
| Total                   | <u>\$ 2,317,802</u>            | <u>\$ 398,206</u>              | <u>\$ 1,790,133</u>             | <u>\$ 4,506,141</u>       | <u>\$ 427,066,849</u> | <u>\$ 431,572,990</u>                 | <u>\$ 665,998</u>                                                |

## Notes to Consolidated Financial Statements

### Note 5. Allowance for Loan Losses, continued

Loans are generally placed in nonaccrual status when, in management's opinion, the collection of principal and interest is 90 days or more past due, unless the obligation is both well-secured and in the process of collection. When interest accrual is discontinued, all unpaid accrued interest is reversed. Payments on nonaccrual loans are applied to the principal balance. No interest income was recognized on impaired loans subsequent to the nonaccrual status designation. A loan is returned to accrual status when the borrower makes consistent payments according to the contractual terms and the future payments are reasonably assured. The following is a schedule of loans receivable, by portfolio segment, on nonaccrual status as of December 31, 2022 and 2021:

|                         | <u>2022</u>       | <u>2021</u>         |
|-------------------------|-------------------|---------------------|
| Commercial              | \$ 2,876          | \$ 16,077           |
| Commercial Real Estate  | -                 | 662,934             |
| Consumer                | 20,441            | 197,365             |
| Residential - Prime     | 693,463           | 619,156             |
| Agricultural & Raw Land | 228,912           | 234,312             |
|                         | <u>\$ 945,692</u> | <u>\$ 1,729,844</u> |

The Bank uses several metrics as credit quality indicators of current or potential risks in the loan portfolio. These indicators include, but are not limited to, credit bureau reports, loan-to-value ratios, internal risk ratings, current financial information, historical payment experience, economic conditions, and trends in net charge-offs and nonperforming loans. As part of the ongoing monitoring of the credit quality of the Bank's loan portfolio, every loan is assigned a risk rating grade at the time of loan origination. The risk ratings are formally reviewed for appropriateness over the life of the loan on at least an annual basis. The formal external review occurs during the fourth quarter to correspond to the Bank's fiscal year-end. In addition, quarterly internal reviews occur for specific loans identified by loan administration to ensure loans with potential material impact are captured on an interim basis. These processes historically provide a predictive element to assist management in their efforts to quantify losses. The quarterly review is an important process to accurately identify impaired loans, a critical component in the allowance for loan losses calculation. The credit quality indicators are periodically reviewed and updated on a case-by-case basis.

Listed from the least risk to the highest risk, management uses a nine point internal risk rating system to monitor the credit quality of the non-consumer segments of the loan portfolio.

**Excellent:** The borrower is typically a long established, well-seasoned company with a significant market position. It possesses unquestioned asset quality, liquidity, and excellent sales and earnings trends. Leverage, if present, is well below industry norms. Borrower appears to have capacity to meet all of its obligations under almost any circumstances. If a business, the borrowing entity's management has extensive experience and depth.

**Good:** The borrower demonstrates a strong and liquid financial condition based upon current financial information and qualifies to borrow on an unsecured basis under most circumstances. If borrowing is secured, collateral is readily marketable and amply margined. Repayment sources are well defined and more than adequate. Credit checks and prior lending experiences with the company, if any, are fully satisfactory. The borrower's cash flow comfortably exceeds total current obligations.

**Satisfactory:** The borrower provides current financial information reflecting a satisfactory financial condition and reasonable debt service capacity. If borrowing is secured, collateral is marketable, adequately margined at the present time, and expected to afford coverage to maturity. Repayment understandings are documented, sources are considered adequate, and repayment terms are appropriate. Credit checks and prior experience, if any, are satisfactory. The borrower is usually established and is attractive to other financial institutions. If a business, the borrower's balance sheet is stable and sales and earnings are steady and predictable.

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## Notes to Consolidated Financial Statements

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### Note 5. Allowance for Loan Losses, continued

**Acceptable:** While an acceptable credit risk to the Bank, the borrower will generally demonstrate a higher leveraged, less liquid balance sheet and capacity to service debt, while steady, may be less well-defined. Repayment terms may not be appropriate for individual transactions. Borrower is generally acceptable to other financial institutions; however, secured borrowing is the norm. Collateral marketability and margin are acceptable at the present time but may not continue to be so. Credit checks or prior experience, if any, reveals some, but not serious, slowness in paying. If a business, its management experience may be limited or have less depth than a Satisfactory borrower. Sensitivity to economic or credit cycles exists, and staying power could be a problem.

**Pass/Watch:** Loan coverage is somewhat erratic, future coverage is uncertain, liquidity is strained and leverage capacity is considered minimal. Indicators of potential deterioration of repayment sources have resulted in uncertainty or unknown factors concerning the status of the credit. This risk rating is considered transitory in nature. When factors causing the uncertainty have been clearly defined, a risk rating will be assigned commensurate with the risk characteristics and circumstances that exist.

**Special Mention:** While loans to a borrower in this rating category are currently protected (no loss of principal or interest envisioned), they may pose undue or unwarranted credit risks if weaknesses are not checked or corrected. Weaknesses may be limited to one or several trends or developments. Weaknesses may include one or more of the following: a potentially over-extended financial condition, a questionable repayment program, an uncertain level of continuing employment or income, inadequate or deteriorating collateral, inadequate or untimely financial information, management competence or succession issues, and a high degree of vulnerability to outside forces.

**Substandard:** Assets in this category are inadequately protected by the current creditworthiness and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Nonaccrual loans, reduced-earnings loans, and loans to borrowers engaged in bankruptcy proceedings are automatically rated Substandard or lower.

**Doubtful:** A loan rated Doubtful has all of the weaknesses inherent in one rated Substandard with the added characteristic that the weakness may make collection or liquidation in full, on the basis of currently existing facts, highly improbable. A Doubtful rating generally is used when the amount of loss can be projected and that projection exceeds one-third of the balance of outstanding debt but does not exceed two-thirds of that balance. A Doubtful rating is generally applied when the likelihood of significant loss is high.

**Loss:** A Loss rating should be applied when the borrower's outstanding debt is considered uncollectible or of such little value that its continuance as a bankable asset is not warranted. This rating does not suggest that there is absolutely no recovery or salvage value, but that it is not practical or desirable to defer writing off the debt even though a partial recovery may be affected in the future.

For the consumer segment of the loan portfolio, the Bank uses the following definitions:

**Nonperforming:** Loans on nonaccrual status plus loans greater than ninety days past due and still accruing interest.

**Performing:** All current loans plus loans less than ninety days past due.

## Notes to Consolidated Financial Statements

### Note 5. Allowance for Loan Losses, continued

The following is a schedule of the credit quality of loans receivable, by portfolio segment, as of December 31, 2022:

|                              | <u>Commercial</u>    | <u>Commercial<br/>Real Estate</u> | <u>Residential-<br/>Prime</u> | <u>Agricultural<br/>&amp; Raw Land</u> |
|------------------------------|----------------------|-----------------------------------|-------------------------------|----------------------------------------|
| Internal Risk Rating Grades: |                      |                                   |                               |                                        |
| Satisfactory or better       | \$ 4,929,118         | \$ 34,147,950                     | \$ 127,298,070                | \$ 3,424,178                           |
| Acceptable                   | 31,778,653           | 133,910,136                       | 97,958,770                    | 20,557,390                             |
| Pass/Watch                   | 1,277,968            | 1,948,690                         | 4,374,475                     | 1,046,753                              |
| Special Mention              | 468,052              | 413,097                           | 435,155                       | -                                      |
| Substandard                  | 328,652              | 360,950                           | 2,850,202                     | 413,368                                |
| Doubtful                     | -                    | -                                 | -                             | -                                      |
| Total                        | <u>\$ 38,782,443</u> | <u>\$ 170,780,823</u>             | <u>\$ 232,916,672</u>         | <u>\$ 25,441,689</u>                   |
|                              |                      |                                   |                               | <u>Consumer</u>                        |
| Internal Risk Rating Grades: |                      |                                   |                               |                                        |
| Performing                   |                      |                                   |                               | \$ 20,883,623                          |
| Nonperforming                |                      |                                   |                               | 43,622                                 |
| Total                        |                      |                                   |                               | <u>\$ 20,927,245</u>                   |

The following is a schedule of the credit quality of loans receivable, by portfolio segment, as of December 31, 2021:

|                              | <u>Commercial</u>    | <u>Commercial<br/>Real Estate</u> | <u>Residential-<br/>Prime</u> | <u>Agricultural<br/>&amp; Raw Land</u> |
|------------------------------|----------------------|-----------------------------------|-------------------------------|----------------------------------------|
| Internal Risk Rating Grades: |                      |                                   |                               |                                        |
| Satisfactory or better       | \$ 4,627,759         | \$ 40,571,803                     | \$ 119,513,009                | \$ 2,789,013                           |
| Acceptable                   | 27,220,108           | 108,003,090                       | 67,843,859                    | 15,855,933                             |
| Pass/Watch                   | 2,351,481            | 1,243,085                         | 7,196,508                     | 3,329,294                              |
| Special Mention              | 668,482              | 4,224,947                         | 2,226,166                     | -                                      |
| Substandard                  | 671,984              | 1,066,074                         | 3,992,043                     | 601,052                                |
| Doubtful                     | -                    | -                                 | -                             | -                                      |
| Total                        | <u>\$ 35,539,814</u> | <u>\$ 155,108,999</u>             | <u>\$ 200,771,585</u>         | <u>\$ 22,575,292</u>                   |
|                              |                      |                                   |                               | <u>Consumer</u>                        |
| Internal Risk Rating Grades: |                      |                                   |                               |                                        |
| Performing                   |                      |                                   |                               | \$ 17,336,496                          |
| Nonperforming                |                      |                                   |                               | 240,804                                |
| Total                        |                      |                                   |                               | <u>\$ 17,577,300</u>                   |

The Bank evaluated all loan restructurings to determine whether they are troubled debt restructurings (“TDRs”) under the guidance of ASU 2011-02. Upon identifying these loans as TDRs, the Bank identified and prospectively measured them as impaired under the guidance in ASC 310-10-35.

In the determination of the allowance for loan losses, management considers troubled debt restructurings and subsequent defaults in these restructurings. All troubled debt restructurings are considered impaired loans. Loss exposure related to these loans are determined by management on a quarterly basis. There were no new TDRs identified during 2022 or 2021, respectively.

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## Notes to Consolidated Financial Statements

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### Note 6. Property, Equipment and Foreclosed Assets

Components of property and equipment and total accumulated depreciation at December 31 are as follows:

|                               | <u>2022</u>          | <u>2021</u>          |
|-------------------------------|----------------------|----------------------|
| Land                          | \$ 4,137,371         | \$ 4,137,371         |
| Construction in process       | 7,840                | 137,469              |
| Buildings and improvements    | 12,730,690           | 12,616,704           |
| Furniture and equipment       | <u>5,419,453</u>     | <u>5,184,781</u>     |
|                               | 22,295,354           | 22,076,325           |
| Less accumulated depreciation | <u>8,232,415</u>     | <u>7,707,285</u>     |
|                               | <u>\$ 14,062,939</u> | <u>\$ 14,369,040</u> |

Depreciation expense for 2022 and 2021 was \$907,834 and \$837,232, respectively.

#### *Lessor Activities*

The Bank leased out a portion of its loan administration facility and received rental income of \$9,000 in 2022 and \$8,250 in 2021.

The Bank leased out a portion of two branch facilities under a lease and received rental income of \$38,400 in 2022 and \$39,150 in 2021.

The Bank leases office space to Mountain Valley Title Insurance Agency, LLC and to Rockbridge Title Services, LLC each for an annual amount of \$6,500 in 2022 and \$6,200 in 2021. Rental income amounted to \$13,000 and \$12,400 in 2022 and 2021, respectively. Both of these companies are related party interests as subsidiaries of the Bank.

Aggregate rental income for 2022 and 2021 was \$60,400 and \$59,800, respectively. All of the above leases are renewable on an annual basis.

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## Notes to Consolidated Financial Statements

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### Note 6. Property, Equipment and Foreclosed Assets, continued

#### *Lessee Activities*

The Bank leases locations for automated teller machines, equipment, and office space under various operating leases that call for annual payments as follows:

|            |    |               |
|------------|----|---------------|
| 2023       | \$ | 19,507        |
| 2024       |    | 15,300        |
| 2025       |    | 15,765        |
| 2026       |    | 16,242        |
| 2027       |    | 5,468         |
| Thereafter |    | -             |
|            | \$ | <u>72,282</u> |

Aggregate rental expense for 2022 and 2021 was \$22,129 and \$21,485, respectively.

The estimated right-of-use asset and lease liability associated with the above operating leases are included on the Bank's balance sheet in other assets and other liabilities, respectively, as of December 31, 2022 and 2021.

#### *Foreclosed Assets*

The following table summarizes the activity in foreclosed assets:

|                                                           | <u>2022</u> | <u>2021</u>      |
|-----------------------------------------------------------|-------------|------------------|
| Balance, beginning of year                                | \$ 27,050   | \$ 1,961,237     |
| Additions                                                 | -           | 27,050           |
| Sales                                                     | (48,132)    | (414,129)        |
| Loans originated to finance the sale of foreclosed assets | -           | (873,600)        |
| Net gain (loss) on sale                                   | 21,082      | (338,508)        |
| Net write-downs                                           | -           | (335,000)        |
| Balance, end of year                                      | <u>\$ -</u> | <u>\$ 27,050</u> |

At December 31, 2022 and December 31, 2021, the Bank held no foreclosed residential properties.

### Note 7. Deposits

The aggregate amount of time deposits in denominations of \$250,000 or more at December 31, 2022 and 2021 was \$43,407,049 and \$48,722,273, respectively.

At December 31, 2022, the scheduled maturities of time deposits are as follows:

|            |    |                    |
|------------|----|--------------------|
| 2023       | \$ | 67,545,707         |
| 2024       |    | 75,859,977         |
| 2025       |    | 20,103,920         |
| 2026       |    | 10,312,754         |
| 2027       |    | 8,683,545          |
| Thereafter |    | -                  |
|            | \$ | <u>182,505,903</u> |

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## Notes to Consolidated Financial Statements

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### **Note 8. Federal Home Loan Bank Borrowings**

The Federal Home Loan Bank debt at December 31, 2021 of \$3,000,000 was comprised of one fixed rate principal reducing advance with an interest rate of 1.8215%. The original \$5,000,000 advance was issued September 30, 2019 and had a \$1,000,000 annual principal reduction each year over its five-year maturity on September 27, 2024. During 2022, the Bank opted to pay the outstanding debt with the Federal Home Loan Bank of Atlanta early; therefore, there was no balance remaining as of December 31, 2022. As a result of the prepayment, the Bank recognized \$48,137 in income. The Bank had loans pledged as collateral on these borrowings at December 31, 2022 totaling \$32,512,777 and Federal Home Loan Bank stock with a book value of \$362,000.

### **Note 9. Short-Term Debt**

The Bank has established various credit facilities to provide additional liquidity if and as needed. These facilities from correspondent banks included unsecured lines of credit, a secured line of credit and a repurchase agreement line of credit totaling \$56,000,000 and \$46,500,000, at December 31, 2022 and 2021, respectively. The Bank had no outstanding balance against these lines at December 31, 2022 and December 31, 2021.

In addition, the Bank has a secured line of credit of approximately \$32,513,000 with the Federal Home Loan Bank of Atlanta as of December 31, 2022. Any borrowings from the Federal Home Loan Bank are secured by a blanket collateral agreement on a pledged portion of the Bank's 1-to-4 family residential real estate loans, multifamily mortgage loans, and commercial mortgage collateral. At December 31, 2022, a \$30,000,000 letter of credit in favor of the Commonwealth of Virginia-Treasury Board, to secure public deposits, was utilized from this line of credit. The Bank had no outstanding balance at December 31, 2022, compared to \$3,000,000 at December 31, 2021. This pledging arrangement reduced the available credit for secondary liquidity needs to \$2,513,000.

The Bank has established a Discount Window facility at the Federal Reserve Bank of Richmond as part of its Contingency Liquidity Plan. Collateral would have to be pledged in order to borrow from the facility. No balance was outstanding on this line at December 31, 2022 or 2021.

### **Note 10. Fair Values Measurements**

#### ***Determination of Fair Value***

The Bank uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. In accordance with the "Fair Value Measurement and Disclosures" topic of FASB ASC, the fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Bank's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

The fair value guidance provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions.

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

The fair value of net loans is based on estimated cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. This does not include

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## Notes to Consolidated Financial Statements

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### **Note 10. Fair Value Measurements**

#### ***Fair Value Determination, continued***

consideration of liquidity that market participants would use to value such loans. The estimated fair values of deposits are based on estimated cash flows discounted at market interest rates.

The fair value of off-balance sheet financial instruments is considered immaterial. These off-balance sheet financial instruments are commitments to extend credit and are either short-term in nature or subject to immediate repricing.

#### ***Fair Value Hierarchy***

The Bank groups assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine the fair value. These levels are:

Level 1 – Valuation is based upon quoted prices for identical instruments traded in active markets.

Level 2 – Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3 – Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include the use of option pricing models, discounted cash flow models and similar techniques.

The following is a description of valuation methodologies used for assets and liabilities recorded at fair value:

#### ***Securities Available for Sale***

Securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active or over-the-counter markets, and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets.

#### ***Foreclosed Assets***

Foreclosed assets are recorded at the lower of investment in the loan or fair value at acquisition. During the holding phase, foreclosed assets are carried at the lower of the carrying value or fair value. Fair value is based on independent observable market prices or appraised values of the collateral, which the Bank considers to be Level 2 inputs. When the appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Bank records the foreclosed asset as nonrecurring Level 3.

#### ***Loans, net***

Other than the loans held for sale portfolio, the Bank does not record loans at fair value on a recurring basis, however, from time to time, a loan is considered impaired and an allowance for loan loss is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan are considered impaired. Once a loan is identified as individually impaired, management measures impairment. The fair value of impaired loans is estimated using one of several methods, including the collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring a specific allowance represent loans for which the fair value of expected repayments or collateral

## Notes to Consolidated Financial Statements

### Note 10. Fair Value Measurements, continued

#### *Loans, net, continued*

exceed the recorded investment in such loans. At December 31, 2022 and 2021, substantially all impaired loans were evaluated based upon the fair value of collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Bank records the loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Bank records the loan as nonrecurring Level 3. When management performs an in-house appraisal using data such as comparable sales analysis, analysis on tax assessments, and physical inspection to determine the fair value, the Bank records the loans as nonrecurring Level 3.

#### *Deposits*

Deposits without a stated maturity, including demand, interest-bearing demand, and savings accounts, are reported at their carrying value in accordance with authoritative accounting guidance. No value has been assigned to the franchise value of these deposits. For other types of deposits with fixed maturities, fair value has been estimated by discounting future cash flows based on interest rates currently being offered on deposits with similar characteristics and maturities.

The carrying amounts and estimated fair values of the Bank's financial instruments as of December 31, 2022 and 2021 are presented below.

|                                |                    |               | Fair Value Measurements As of December 31, 2022 Using                      |                                                     |                                                    |
|--------------------------------|--------------------|---------------|----------------------------------------------------------------------------|-----------------------------------------------------|----------------------------------------------------|
|                                |                    |               | Quoted Prices<br>in Active<br>Markets for<br>Identical Assets<br>(Level 1) | Significant Other<br>Observable Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| (In Thousands)                 | Carrying<br>Amount | Fair<br>Value |                                                                            |                                                     |                                                    |
| <b>Financial assets</b>        |                    |               |                                                                            |                                                     |                                                    |
| Cash and cash equivalents      | \$ 100,928         | \$ 100,928    | \$ 100,928                                                                 | \$ -                                                | \$ -                                               |
| Securities, held to maturity   | 9,950              | 9,950         | -                                                                          | -                                                   | 9,950                                              |
| Securities, available for sale | 92,552             | 92,552        | -                                                                          | 92,552                                              | -                                                  |
| Restricted equity securities   | 412                | 412           | -                                                                          | 412                                                 | -                                                  |
| Loans held for sale            | 177                | 177           | -                                                                          | 177                                                 | -                                                  |
| Loans, net                     | 482,162            | 479,610       | -                                                                          | -                                                   | 479,610                                            |
| Bank owned life insurance      | 4,313              | 4,313         | -                                                                          | 4,313                                               | -                                                  |
| Accrued income                 | 1,828              | 1,828         | -                                                                          | 1,828                                               | -                                                  |
| <b>Financial liabilities</b>   |                    |               |                                                                            |                                                     |                                                    |
| Deposits                       | \$ 643,923         | \$ 559,328    | \$ -                                                                       | \$ 559,328                                          | \$ -                                               |
| Accrued interest payable       | 324                | 324           | -                                                                          | 324                                                 | -                                                  |

## Notes to Consolidated Financial Statements

### Note 10. Fair Value Measurements, continued

|                                |                 |            | Fair Value Measurements As of December 31, 2021 Using |                                               |                                           |
|--------------------------------|-----------------|------------|-------------------------------------------------------|-----------------------------------------------|-------------------------------------------|
|                                |                 |            | Quoted Prices                                         |                                               |                                           |
|                                | Carrying Amount | Fair Value | in Active Markets for Identical Assets (Level 1)      | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| (In Thousands)                 |                 |            |                                                       |                                               |                                           |
| <i>Financial assets</i>        |                 |            |                                                       |                                               |                                           |
| Cash and cash equivalents      | \$ 143,123      | \$ 143,123 | \$ 143,123                                            | \$ -                                          | \$ -                                      |
| Securities, held to maturity   | 8,950           | 8,950      | -                                                     | -                                             | 8,950                                     |
| Securities, available for sale | 57,530          | 57,530     | -                                                     | 57,530                                        | -                                         |
| Restricted equity securities   | 561             | 561        | -                                                     | 561                                           | -                                         |
| Loans held for sale            | 408             | 408        | -                                                     | 408                                           | -                                         |
| Loans, net                     | 425,899         | 421,325    | -                                                     | -                                             | 421,325                                   |
| Bank owned life insurance      | 4,401           | 4,401      | -                                                     | 4,401                                         | -                                         |
| Accrued income                 | 1,372           | 1,372      | -                                                     | 1,372                                         | -                                         |
| <i>Financial liabilities</i>   |                 |            |                                                       |                                               |                                           |
| Deposits                       | \$ 597,123      | \$ 596,462 | \$ -                                                  | \$ 596,462                                    | \$ -                                      |
| Other borrowings               | 3,000           | 3,000      | -                                                     | 3,000                                         | -                                         |
| Accrued interest payable       | 197             | 197        | -                                                     | 197                                           | -                                         |

### Assets Measured at Fair Value on a Recurring Basis

The tables below present the recorded amount of assets and liabilities measured at fair value on a recurring basis.

|                                  |    | Fair Value Measurements<br>at December 31, 2022 Using                      |                                                        |                                                    |      |
|----------------------------------|----|----------------------------------------------------------------------------|--------------------------------------------------------|----------------------------------------------------|------|
|                                  |    | Quoted Prices<br>in Active<br>Markets for<br>Identical Assets<br>(Level 1) | Significant<br>Other Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |      |
| <u>Total</u>                     |    |                                                                            |                                                        |                                                    |      |
| <b>(In Thousands)</b>            |    |                                                                            |                                                        |                                                    |      |
| Securities available for sale:   |    |                                                                            |                                                        |                                                    |      |
| Government-sponsored enterprises | \$ | 49,222                                                                     | \$ -                                                   | \$ 49,222                                          | \$ - |
| State and municipal securities   |    | 17,525                                                                     | -                                                      | 17,525                                             | -    |
| U.S. treasury securities         |    | 14,477                                                                     | -                                                      | 14,477                                             | -    |
| Mortgaged-backed securities      |    | 10,491                                                                     | -                                                      | 10,491                                             | -    |
| Corporate securities             |    | 837                                                                        | -                                                      | 837                                                | -    |
| Total assets at fair value       | \$ | 92,552                                                                     | \$ -                                                   | \$ 92,552                                          | \$ - |

|                                  |    | Fair Value Measurements<br>at December 31, 2021 Using |                                                                            |                                                        |                                                    |
|----------------------------------|----|-------------------------------------------------------|----------------------------------------------------------------------------|--------------------------------------------------------|----------------------------------------------------|
|                                  |    | Total                                                 | Quoted Prices<br>in Active<br>Markets for<br>Identical Assets<br>(Level 1) | Significant<br>Other Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|                                  |    |                                                       |                                                                            |                                                        |                                                    |
| <b>(In Thousands)</b>            |    |                                                       |                                                                            |                                                        |                                                    |
| Securities available for sale:   |    |                                                       |                                                                            |                                                        |                                                    |
| Government-sponsored enterprises | \$ | 46,416                                                | \$ -                                                                       | \$ 46,416                                              | \$ -                                               |
| State and municipal securities   |    | 10,626                                                | -                                                                          | 10,626                                                 | -                                                  |
| Corporate securities             |    | 487                                                   | -                                                                          | 487                                                    | -                                                  |
| Total assets at fair value       | \$ | 57,529                                                | \$ -                                                                       | \$ 57,529                                              | \$ -                                               |

## Notes to Consolidated Financial Statements

### Note 10. Fair Value Measurements, continued

#### *Assets Measured at Fair Value on a Nonrecurring Basis*

The Bank may be required from time to time, to measure certain assets at fair value on a nonrecurring basis. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. Balances are net of specific reserves. Assets measured at fair value on a nonrecurring basis are included in the table below.

| Fair Value Measurements<br>at December 31, 2022 Using |              |                                                                            |                                                        |                                                    |
|-------------------------------------------------------|--------------|----------------------------------------------------------------------------|--------------------------------------------------------|----------------------------------------------------|
|                                                       |              | Quoted Prices<br>in Active<br>Markets for<br>Identical Assets<br>(Level 1) | Significant<br>Other Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| (In Thousands)                                        | Total        |                                                                            |                                                        |                                                    |
| Impaired loans:                                       |              |                                                                            |                                                        |                                                    |
| Commercial                                            | \$ -         | \$ -                                                                       | \$ -                                                   | \$ -                                               |
| Agricultural & Raw Land                               | -            | -                                                                          | -                                                      | -                                                  |
| Consumer                                              | -            | -                                                                          | -                                                      | -                                                  |
| Residential - Prime                                   | 93           | -                                                                          | 93                                                     | -                                                  |
| Total impaired loans                                  | 93           | -                                                                          | 93                                                     | -                                                  |
| Foreclosed assets                                     | -            | -                                                                          | -                                                      | -                                                  |
| Total assets at fair value                            | <u>\$ 93</u> | <u>\$ -</u>                                                                | <u>\$ -</u>                                            | <u>\$ -</u>                                        |

| Fair Value Measurements<br>at December 31, 2021 Using |              |                                                                            |                                                        |                                                    |
|-------------------------------------------------------|--------------|----------------------------------------------------------------------------|--------------------------------------------------------|----------------------------------------------------|
|                                                       |              | Quoted Prices<br>in Active<br>Markets for<br>Identical Assets<br>(Level 1) | Significant<br>Other Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| (In Thousands)                                        | Total        |                                                                            |                                                        |                                                    |
| Impaired loans:                                       |              |                                                                            |                                                        |                                                    |
| Commercial                                            | \$ -         | \$ -                                                                       | \$ -                                                   | \$ -                                               |
| Agricultural & Raw Land                               | -            | -                                                                          | -                                                      | -                                                  |
| Consumer                                              | -            | -                                                                          | -                                                      | -                                                  |
| Residential - Prime                                   | -            | -                                                                          | -                                                      | -                                                  |
| Total impaired loans                                  | -            | -                                                                          | -                                                      | -                                                  |
| Foreclosed assets                                     | 27           | -                                                                          | 27                                                     | -                                                  |
| Total assets at fair value                            | <u>\$ 27</u> | <u>\$ -</u>                                                                | <u>\$ 27</u>                                           | <u>\$ -</u>                                        |

### Note 11. Benefit Plans

#### *Pension Plan*

For the years ended December 31, 2022 and 2021, the Bank had a noncontributory cash balance pension plan (“Plan”). The Plan is sponsored by the Virginia Bankers Association and covers all eligible employees with at least one year of service who have attained the age of twenty-one. The Bank is permitted to make annual contributions to the Plan. Contribution credits are based on a tier for age and years of service. Interest is credited annually based on a rate tied to the 10-year Treasury rate and is guaranteed to meet the minimum threshold established by the IRS and not to be less than 3% on an annual basis. Upon retirement, the Plan permits lump sum, periodic installments, and monthly benefit payment options.

## Notes to Consolidated Financial Statements

### Note 11. Benefit Plans, continued

#### *Pension Plan, continued*

The Bank includes the net periodic benefit cost comprised of service cost and other components in with salaries and employee benefits on the income statement.

The Plan was overfunded at December 31, 2022 and 2021. The plan remained overfunded in 2022 primarily due to an actuarial gain which was partially offset by an actual loss on plan assets. The following table is a summary of the plan's funded status for each year ended December 31:

|                                                                                                                               | <u>2022</u>         | <u>2021</u>        |
|-------------------------------------------------------------------------------------------------------------------------------|---------------------|--------------------|
| <b><i>Change in benefit obligation</i></b>                                                                                    |                     |                    |
| Benefit obligation at beginning of year                                                                                       | \$ 5,989,856        | \$ 5,971,884       |
| Service cost                                                                                                                  | 381,839             | 347,161            |
| Interest cost                                                                                                                 | 146,169             | 144,600            |
| Actuarial (gain) loss                                                                                                         | (1,393,040)         | 32,522             |
| Benefits paid                                                                                                                 | <u>(535,165)</u>    | <u>(506,311)</u>   |
| Benefit obligation at end of year                                                                                             | <u>4,589,659</u>    | <u>5,989,856</u>   |
| <b><i>Change in plan assets</i></b>                                                                                           |                     |                    |
| Fair value of plan assets at beginning of year                                                                                | 6,038,777           | 5,785,259          |
| Actual (loss) gain on plan assets                                                                                             | (1,337,999)         | 609,829            |
| Employer contributions                                                                                                        | 500,000             | 150,000            |
| Benefits paid                                                                                                                 | <u>(535,165)</u>    | <u>(506,311)</u>   |
| Fair value of plan assets at end of year                                                                                      | <u>4,665,613</u>    | <u>6,038,777</u>   |
| Funded status, over (under) at end of year                                                                                    | <u>\$ 75,954</u>    | <u>\$ 48,921</u>   |
| <b><i>Amounts recognized on the balance sheet</i></b>                                                                         |                     |                    |
| Other assets                                                                                                                  | \$ 405,727          | \$ 312,616         |
| Net assets (liabilities)                                                                                                      | <u>\$ 405,727</u>   | <u>\$ 312,616</u>  |
| <b><i>Amounts recognized in accumulated other comprehensive income:</i></b>                                                   |                     |                    |
| Actuarial loss, net of tax                                                                                                    | <u>\$ 1,240,576</u> | <u>\$ 991,995</u>  |
| <b><i>Components of net periodic benefit cost and other amounts recognized in accumulated other comprehensive income:</i></b> |                     |                    |
| <b><i>Net periodic benefit cost</i></b>                                                                                       |                     |                    |
| Service cost                                                                                                                  | \$ 381,839          | \$ 347,161         |
| Interest cost                                                                                                                 | 146,169             | 144,600            |
| Expected return on plan assets                                                                                                | (429,587)           | (412,695)          |
| Amortization of prior service cost                                                                                            | 6,628               | 6,628              |
| Recognized net actuarial loss                                                                                                 | <u>53,259</u>       | <u>56,451</u>      |
| Net periodic benefit cost                                                                                                     | <u>158,308</u>      | <u>142,145</u>     |
| <b><i>Other changes in plan assets and benefit obligations recognized in other comprehensive income</i></b>                   |                     |                    |
| Net actuarial loss (gain)                                                                                                     | 314,659             | (227,691)          |
| Tax benefit (expense) on actuarial gain                                                                                       | <u>(66,078)</u>     | <u>47,815</u>      |
| Total recognized in other comprehensive (income) loss                                                                         | <u>248,581</u>      | <u>(179,876)</u>   |
| Total recognized in net periodic benefit cost and other comprehensive loss                                                    | <u>\$ 406,889</u>   | <u>\$ (37,731)</u> |

# Notes to Consolidated Financial Statements

## Note 11. Benefit Plans, continued

### Pension Plan, continued

|                                                             | <u>2022</u> | <u>2021</u> |
|-------------------------------------------------------------|-------------|-------------|
| <i>Assumptions</i>                                          |             |             |
| <i>Weighted-average assumptions at December 31</i>          |             |             |
| Discount rate used for net periodic pension cost            | 2.50%       | 2.50%       |
| Discount rate used for disclosure                           | 4.90%       | 2.50%       |
| Expected return on plan assets                              | 7.25%       | 7.25%       |
| Rate of compensation increase                               | 3.00%       | 3.00%       |
| Rate of compensation increase for net periodic pension cost | 3.00%       | 3.00%       |

Using the same fair value hierarchy described in Note 10, the fair values of the Bank's pension plan assets, by asset category, are as follows:

| <u>December 31, 2022</u>                    | <u>Total</u>        | <u>Level 1</u>      | <u>Level 2</u>     | <u>Level 3</u>     |
|---------------------------------------------|---------------------|---------------------|--------------------|--------------------|
| Cash equivalents and short term investments | \$ -                | \$ -                | \$ -               | \$ -               |
| Mutual funds – equities                     | 2,828,303           | 2,828,303           | -                  | -                  |
| Mutual funds – fixed income                 | 1,837,310           | 1,837,310           | -                  | -                  |
| Total assets at fair value                  | <u>\$ 4,665,613</u> | <u>\$ 4,665,613</u> | <u>\$ -</u>        | <u>\$ -</u>        |
| <br><u>December 31, 2021</u>                | <br><u>Total</u>    | <br><u>Level 1</u>  | <br><u>Level 2</u> | <br><u>Level 3</u> |
| Cash equivalents and short term investments | \$ -                | \$ -                | \$ -               | \$ -               |
| Mutual funds – equities                     | 3,743,544           | 3,743,544           | -                  | -                  |
| Mutual funds – fixed income                 | 2,295,233           | 2,295,233           | -                  | -                  |
| Total assets at fair value                  | <u>\$ 6,038,777</u> | <u>\$ 6,038,777</u> | <u>\$ -</u>        | <u>\$ -</u>        |

A contribution of \$150,000 is expected to be made in 2023.

Estimated future benefit payments, which reflect expected future service, as appropriate, are as follows:

|           |            |
|-----------|------------|
| 2023      | \$ 831,803 |
| 2024      | 310,685    |
| 2025      | 460,903    |
| 2026      | 461,490    |
| 2027      | 105,882    |
| 2028-2032 | 2,003,916  |

### Long-term rate of return

The plan sponsor selects the expected long-term rate-of-return-on-assets assumption in consultation with their investment advisors and actuary. This rate is intended to reflect the average rate of earnings expected to be earned on the funds invested or to be invested to provide plan benefits. Historical performance is reviewed, especially with respect to real rates of return (net of inflation), for the major asset classes held or anticipated to be held by the trust, and for the trust itself. Undue weight is not given to recent experience – that may not continue over the measurement period – with higher significance placed on current forecasts of future long-term economic conditions.

Because assets are held in a qualified trust, anticipated returns are not reduced for taxes. Further, solely for this purpose, the plan is assumed to continue in force and not terminate during the period during which assets are invested. However, consideration is given to the potential impact of current and future investment policy, cash flow into and out of the trust, and expenses (both investment and non-investment) typically paid from plan assets (to the extent such expenses are not explicitly estimated within periodic cost).

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## Notes to Consolidated Financial Statements

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### Note 11. Benefit Plans, continued

#### *Pension Plan assumptions, continued*

##### *Discount Rate*

The process used to select the discount rate assumption under ASC 715 takes into account the benefit cash flow and the segmented yields on high quality corporate bonds that would be available to provide for the payment of the benefit cash flow. A single effective discount rate, rounded to the nearest 0.25%, is then established that produces an equivalent discounted present value.

##### *Asset allocation and investment strategies*

The pension plan's weighted-average asset allocations, by asset category, are as follows for the year-ended December 31:

| Asset Category              | 2022 | 2021 |
|-----------------------------|------|------|
| Mutual funds – fixed income | 38%  | 38%  |
| Mutual funds – equity       | 62%  | 62%  |
| Total                       | 100% | 100% |

Bank management elects an asset allocation for the plan annually. The election is based on management's assessment of the fixed income and equities markets and the economic outlook when matching potential risk and return for employee participants. The trust fund is diversified to maintain a reasonable level of risk without imprudently sacrificing return. The targeted asset allocation was 40% fixed income and 60% equities in 2022 and 2021. The Investment Manager selects fund managers with demonstrated experience and expertise and funds with demonstrated historical performance for the implementation of the Plan's investment strategy. The Investment Manager considers both actively and passively managed investment strategies and allocates funds across the asset classes to develop an efficient investment structure.

It is the responsibility of the Trustee to administer the investments of the Trust within reasonable costs, being careful to avoid sacrificing quality. These costs include, but are not limited to, management and custodial fees, consulting fees, transaction costs and other administration costs chargeable to the Trust.

##### *Concentration of risk*

No concentration of risk was identified in the plan.

## Notes to Consolidated Financial Statements

### Note 11. Benefit Plans, continued

#### *Post-Retirement Health Insurance*

The Bank sponsors a post-retirement health care plan for certain retired employees. The health plan has an annual limitation (a “cap”) on the dollar amount of the employer’s share of the cost of covered benefits incurred by a plan participant. The retiree is responsible, therefore, for the amount by which the cost of the benefit coverage under the plan incurred during a year exceeds that cap. No health care cost increases have been factored into the health plan’s actuarial calculations due to this cap. The plan remains frozen with coverage continuing for three existing retiree participants. The following tables summarize the Bank’s post retirement plan obligations, assets, funded status, and the assumptions and components of net periodic benefit costs using a measurement date of December 31, 2022 and 2021:

|                                                                                                                                      | <u>2022</u>        | <u>2021</u>        |
|--------------------------------------------------------------------------------------------------------------------------------------|--------------------|--------------------|
| <b><i>Change in benefit obligation</i></b>                                                                                           |                    |                    |
| Benefit obligation at beginning of year                                                                                              | \$ 90,206          | \$ 97,721          |
| Interest cost                                                                                                                        | 1,709              | 1,394              |
| Actuarial loss                                                                                                                       | (29,688)           | 691                |
| Benefits paid                                                                                                                        | (9,600)            | (9,600)            |
| Benefit obligation at end of year                                                                                                    | <u>52,627</u>      | <u>90,206</u>      |
| <b><i>Change in plan assets</i></b>                                                                                                  |                    |                    |
| Fair value of plan assets at beginning of year                                                                                       | -                  | -                  |
| Employer contribution                                                                                                                | 9,600              | 9,600              |
| Benefits paid                                                                                                                        | (9,600)            | (9,600)            |
| Fair value of plan assets at end of year                                                                                             | -                  | -                  |
| Funded status, over (under) at end of year                                                                                           | <u>\$ (52,627)</u> | <u>\$ (90,206)</u> |
| <b><i>Amounts recognized on the balance sheet</i></b>                                                                                |                    |                    |
| Other liabilities                                                                                                                    | \$ (60,311)        | \$ (91,655)        |
| Net liabilities                                                                                                                      | <u>\$ (60,311)</u> | <u>\$ (91,655)</u> |
| <b><i>Amounts recognized in accumulated other comprehensive income:</i></b>                                                          |                    |                    |
| Actuarial gain                                                                                                                       | \$ (36,589)        | \$ (6,901)         |
| Prior service cost                                                                                                                   | -                  | -                  |
| Deferred tax expense                                                                                                                 | 7,684              | 1,449              |
| Net accumulated other comprehensive loss (income)                                                                                    | <u>\$ (28,905)</u> | <u>\$ (5,452)</u>  |
| <b><i>Components of net periodic postretirement cost and other amounts recognized in accumulated other comprehensive income:</i></b> |                    |                    |
| <b><i>Net periodic benefit cost</i></b>                                                                                              |                    |                    |
| Interest cost                                                                                                                        | \$ 1,709           | \$ 1,394           |
| Amortization of prior service cost                                                                                                   | -                  | 14,716             |
| Amortization of net gain                                                                                                             | -                  | -                  |
| Net periodic postretirement cost                                                                                                     | <u>1,709</u>       | <u>16,110</u>      |
| <b><i>Other changes in plan assets and benefit obligations recognized in other comprehensive income</i></b>                          |                    |                    |
| Actuarial (gain) loss                                                                                                                | (29,688)           | 691                |
| Amortization of prior service cost                                                                                                   | -                  | (14,716)           |
| Tax benefit on comprehensive income (loss)                                                                                           | 6,234              | 2,945              |
| Total recognized in other comprehensive loss                                                                                         | <u>(23,454)</u>    | <u>(11,080)</u>    |
| Total recognized in net periodic postretirement cost and other comprehensive (income) loss                                           | <u>\$ (21,745)</u> | <u>\$ 5,030</u>    |

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## Notes to Consolidated Financial Statements

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### Note 11. Benefit Plans, continued

#### *Post-Retirement Health Insurance, continued*

The Bank expects to recognize no amortization of transition obligation in 2023.

The discount rate assumption in determining the benefit relating to the untrended post-retirement health care plan at December 31, 2022, was 2.0%. Since the post-retirement health insurance benefit plan is untrended, increases and decreases in health care cost trend rates, expected rate of return on plan assets, and the rate of compensation increase is not applicable.

Employer contributions are expected to be \$7,200 in 2023.

Estimated future benefit payments by the plan are as follows:

|           |    |        |
|-----------|----|--------|
| 2023      | \$ | 7,200  |
| 2024      |    | 6,481  |
| 2025      |    | 6,457  |
| 2026      |    | 6,052  |
| 2027      |    | 5,627  |
| 2028-2032 |    | 21,393 |

#### *Deferred Compensation Plan*

Funded deferred compensation plans have been adopted for certain members of the Board of Directors and executive employees. The corresponding assets and liabilities of the plans are held by a third party through the Virginia Bankers Association and totaled \$790,628 and \$974,279 for the Director Plan at December 31, 2022 and 2021, respectively. The Executive Plan had no active participants and a zero balance at December 31, 2022 and 2021.

#### *Profit Sharing/Thrift Plan*

The Bank provides a profit sharing/thrift plan for its employees to which contributions are made at the discretion of the Board of Directors. All full-time employees, age 18 and older, are eligible to participate and are automatically enrolled, unless they choose to opt-out of the plan, after completing their first six months of service. The plan allows for pretax employee contributions of up to the maximum allowed by the IRS. In 2022 and 2021, the first 1% of employee contributions was matched 100% by the Bank. The next 5% of employee contributions was matched 50% by the Bank. Employer contributions, including a 2% accrual for profit sharing, to the plan amounted to \$341,697 in 2022. Employer contributions were \$318,637 in 2021.

### Note 12. Income Taxes

#### *Current and Deferred Income Tax Components*

The components of income tax expense (benefit) are as follows:

|                           | <u>2022</u>         | <u>2021</u>         |
|---------------------------|---------------------|---------------------|
| <b>Current</b>            |                     |                     |
| Federal                   | \$ 2,085,874        | \$ 1,815,523        |
| State                     | 29,015              | 20,703              |
|                           | <u>2,114,889</u>    | <u>1,836,226</u>    |
| <b>Deferred</b>           |                     |                     |
| Federal                   | (125,351)           | (175,935)           |
| State                     | 313                 | 27,627              |
|                           | <u>(125,038)</u>    | <u>(148,308)</u>    |
| <b>Income Tax Expense</b> | <u>\$ 1,989,851</u> | <u>\$ 1,687,918</u> |

## Notes to Consolidated Financial Statements

### Note 12. Income Taxes, continued

#### *Rate Reconciliation*

A reconciliation of income tax expense computed at the statutory federal income tax rate to income tax expense included in the consolidated statements of income is as follows:

|                               | <u>2022</u>         | <u>2021</u>         |
|-------------------------------|---------------------|---------------------|
| Tax at statutory federal rate | \$ 2,057,015        | \$ 1,799,143        |
| Tax exempt interest income    | (48,099)            | (35,025)            |
| Other                         | (19,065)            | (76,200)            |
| Income tax expense            | <u>\$ 1,989,851</u> | <u>\$ 1,687,918</u> |

#### *Deferred Income Tax Analysis*

The significant components of net deferred tax assets at December 31 are summarized as follows:

|                                                        | <u>2022</u>         | <u>2021</u>        |
|--------------------------------------------------------|---------------------|--------------------|
| <b><i>Deferred tax assets</i></b>                      |                     |                    |
| Allowance for loan losses                              | \$ 1,404,155        | \$ 1,191,623       |
| Deferred compensation                                  | 208,121             | 185,442            |
| Pension plan                                           | 329,773             | 263,695            |
| Investment in pass-through entities                    | 23,424              | 23,737             |
| Interest on nonaccrual loans                           | 36,060              | 34,871             |
| Accrued unpaid compensation                            | 77,910              | 68,460             |
| Net unrealized losses on securities available for sale | 1,830,603           | 224,027            |
| Other                                                  | 118,727             | 158,970            |
| Deferred tax assets                                    | <u>4,028,773</u>    | <u>2,150,825</u>   |
| <b><i>Deferred tax liabilities</i></b>                 |                     |                    |
| Depreciation                                           | (763,618)           | (750,883)          |
| Bank owned life insurance                              | (100,773)           | (84,261)           |
| Accrued pension costs                                  | (377,299)           | (326,469)          |
| Post-retirement health benefits                        | (7,684)             | (1,449)            |
| Other                                                  | (179)               | -                  |
| Deferred tax liabilities                               | <u>(1,249,553)</u>  | <u>(1,163,062)</u> |
| Net deferred tax asset                                 | <u>\$ 2,779,220</u> | <u>\$ 987,763</u>  |

The Bank has analyzed the tax positions taken or expected to be taken in its tax returns and concluded it has no liability related to uncertain tax positions in accordance with accounting guidance on Income Taxes.

The Bank has evaluated the need for a deferred tax valuation allowance for the years ended December 31, 2022 and 2021 in accordance with ASC 740, Income Taxes. Based on a three year taxable income projection and tax strategies which would result in recognition of potential securities gains and the effects of off-setting deferred tax liabilities, the Bank believes that it is more likely than not that the deferred tax assets are realizable. Therefore, no allowance is required.

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## Notes to Consolidated Financial Statements

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### Note 13. Low Income Housing Tax Credits

The Bank is an investor in a housing equity fund. The general purpose of this fund is to encourage and assist participants in investing in low-income residential rental properties located in the Commonwealth of Virginia, develop and implement strategies to maintain projects as low-income housing, deliver Federal Low Income Housing Credits to investors, allocate tax losses and other possible tax benefits to investors, and to preserve and protect project assets. The Bank accounts for this investment under the proportional amortization method and at December 31, 2022, the investment in this fund, recorded in other assets on the consolidated balance sheet, was \$263,477. Total projected tax credits to be received for 2022 are \$47,169 which is based on the most recent estimates received from the fund. Amortization expense for 2022 was \$41,590. At December 31, 2022, the Bank had fully funded its commitment to the housing equity fund. Therefore, no additional capital calls are expected.

### Note 14. Commitments and Contingencies

#### *Litigation*

In the normal course of business the Bank is involved in various legal proceedings. After consultation with legal counsel, management believes that any liability resulting from such proceedings will not be material to the consolidated financial statements.

#### *Financial Instruments with Off-Balance-Sheet Risk*

The Bank is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, credit risk in excess of the amounts recognized in the consolidated balance sheets.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instruments for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as for on-balance-sheet instruments. A summary of commitments at December 31 is as follows:

|                              | <u>2022</u>           | <u>2021</u>           |
|------------------------------|-----------------------|-----------------------|
| Commitments to extend credit | \$ 120,850,000        | \$ 99,861,000         |
| Standby letters of credit    | <u>4,104,000</u>      | <u>3,960,000</u>      |
|                              | <u>\$ 124,954,000</u> | <u>\$ 103,821,000</u> |

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## Notes to Consolidated Financial Statements

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### **Note 14. Commitments and Contingencies, continued**

#### ***Financial Instruments with Off-Balance-Sheet Risk, continued***

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the customer. Collateral held varies, but may include accounts receivable, inventory, property and equipment, residential real estate and income-producing commercial properties.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Collateral held varies as specified above and is required in instances which the Bank deems necessary.

In the normal course of business, the Bank extends commitment letters to fund loans at a future date. The Bank had issued approximately \$40,812,000 in such commitments at December 31, 2022. However, there is no assurance that the loans will be originated and funded due to uncertainty of customer acceptance of the terms and conditions of the agreement.

#### ***Concentrations of Credit Risk***

Substantially all of the Bank's loans, commitments to extend credit, and standby letters of credit have been granted to customers in the Bank's market area and such customers are generally depositors of the Bank. The concentrations of credit by type of loan are set forth in Note 4. The distribution of commitments to extend credit approximates the distribution of loans outstanding. Standby letters of credit are granted primarily to commercial borrowers. Although the Bank has a reasonably diversified loan portfolio, a substantial portion of its debtors' ability to honor their contracts is dependent upon economic conditions in and around the counties of Botetourt, Roanoke, Rockbridge and Franklin the City of Salem, the Town of Vinton, all in Virginia. At December 31, 2022 the Bank had an approximate \$55,763,000 in secured loan concentration balances in 1-4 family residential construction, other construction, land and development, and lots. This amount represents 69% of total risk based capital, complying with the Federal Deposit Insurance Corporation's ("FDIC") suggested guideline of less than 100%.

The Bank also monitors loan concentrations for non-owner occupied commercial real estate, construction, and lot loans. Combined with the categories above, the Bank had approximately \$129,254,000 in concentration balances or 159% of total risk based capital, below the FDIC's suggested guideline of less than 300%. Large individual credit relationships are also monitored to mitigate risk and ensure compliance with applicable laws.

Certain cash deposits maintained by the Bank with other financial institutions are secured by federal depository insurance. At times during the year these accounts are in excess of the FDIC insured limit of \$250,000. The Bank has not experienced losses in such accounts and believes it is not exposed to significant credit risk on cash and cash equivalents.

### **Note 15. Regulatory Restrictions**

Investments in state and municipal securities involve governmental entities within and outside the Bank's market area. The Bank from time to time has cash and cash equivalents on deposit with financial institutions which exceed federally-insured limits.

#### ***Dividends***

As a Virginia banking corporation, the Bank may pay dividends only out of its retained earnings. However, regulatory authorities may limit or prevent payment of dividends by any bank when it is determined that such a limitation is in the public interest and is necessary to ensure financial soundness of the bank.

## Notes to Consolidated Financial Statements

### Note 15. Regulatory Restrictions, continued

#### Capital Requirements

The Bank is subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum regulatory capital requirements can initiate certain mandatory (and possibly additional discretionary) actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements.

Federal banking agencies jointly issued a final rule that provided for an optional and simplified measure of capital adequacy, the community bank leverage ratio framework, for qualifying community banking organizations, consistent with Section 201 of the Economic Growth, Regulatory Relief, and Consumer Protection Act. A qualifying community banking organization is defined as having less than \$10 billion in total consolidated assets, a leverage ratio greater than 9%, off-balance sheet exposures of 25% or less of total consolidated assets, and trading assets and liabilities of 5% or less of total consolidated assets. It also cannot be an advanced approaches institution. Bank of Botetourt qualified to opt-in to the Community Bank Leverage Ratio ("CBLR"). The Coronavirus Aid, Relief, and Economic Security ("CARES") Act temporarily reduced the CBLR minimum ratio from 9.0% to 8.5% at December 31, 2021. The 9.0% CBLR requirement resumed in 2022.

Management believes, as of December 31, 2022 and 2021, respectively, that the Bank met all capital adequacy requirements to which they are subject and was categorized as "well capitalized" as defined by applicable regulations. There are no conditions or events since that date that management believes have changed the Bank's category.

The Bank's actual capital amounts and ratios are presented in the tables below (in thousands except for percentages):

|                                       | <u>Amount</u> | <u>Ratio</u> | <u>Capital Required<br/>To Be Considered<br/>Well Capitalized<br/>CBLR Framework</u> |              |
|---------------------------------------|---------------|--------------|--------------------------------------------------------------------------------------|--------------|
|                                       |               |              | <u>Amount</u>                                                                        | <u>Ratio</u> |
| <b>December 31, 2022:</b>             |               |              |                                                                                      |              |
| Tier 1 Capital<br>(to Average Assets) | \$ 74,491     | 10.3%        | \$ 64,963                                                                            | 9.0%         |
| <b>December 31, 2021:</b>             |               |              |                                                                                      |              |
| Tier 1 Capital<br>(to Average Assets) | \$ 60,967     | 9.1%         | \$ 56,698                                                                            | 8.5%         |

### Note 16. Transactions with Related Parties

The Bank has entered into transactions with its directors, significant shareholders and their affiliates (related parties). Such transactions were made in the ordinary course of business on substantially the same terms and conditions, including interest rates and collateral, as those prevailing at the same time for comparable transactions with other customers, and did not, in the opinion of management, involve more than normal credit risk or present other unfavorable features.

Aggregate loan transactions with related parties were as follows for the year-ended December 31:

|                                   | <u>2022</u>       | <u>2021</u>       |
|-----------------------------------|-------------------|-------------------|
| <b>Balance, beginning</b>         | \$ 263,128        | \$ 399,907        |
| New loans or credit line advances | 218,245           | 359,998           |
| Repayments                        | (85,214)          | (496,777)         |
| <b>Balance, ending</b>            | <u>\$ 396,159</u> | <u>\$ 263,128</u> |

## Notes to Consolidated Financial Statements

### Note 16. Transactions with Related Parties, continued

Deposit transactions with related parties at December 31, 2022 and 2021 were insignificant.

As discussed in Note 6 Property, Equipment and Foreclosed Assets, the Bank had lessee activities with companies of related party interests in both 2022 and 2021.

### Note 17. Stockholders' Equity

#### *Dividend Reinvestment and Stock Purchase Plan*

The Bank's Dividend Reinvestment and Stock Purchase Plan ("DRIP") provides for the issuance of up to 200,000 shares of common stock. Common shares may be acquired on a quarterly basis via full or partial dividend reinvestment, systematic quarterly purchases, or a one-time purchase based on the following methodology. The purchase price of shares purchased by the Plan Administrator is 97% of the stock's market value. Approximately 10 days prior to the transaction day, the Bank requests trade history using third party data from Bloomberg or a similar source. On the date of the request, trade volume and prices are obtained for the preceding three-week period. Using this three-week (15 trading days) measurement period, the volume weighted average price is calculated. A three percent discount is applied to the volume weighted average price to determine the DRIP price.

The following is a summary of the shares of common stock issued from dividends reinvested and optional cash purchases in 2022 and 2021.

|                     | <b>2022</b>   |                       |
|---------------------|---------------|-----------------------|
|                     | <b>Shares</b> | <b>Purchase Price</b> |
| First Quarter       | 4,924         | \$ 26.89              |
| Second Quarter      | 6,956         | 26.61                 |
| Third Quarter       | 4,175         | 26.96                 |
| Fourth Quarter      | 2,829         | 26.78                 |
| Total Shares Issued | 18,884        |                       |
|                     | <b>2021</b>   |                       |
|                     | <b>Shares</b> | <b>Purchase Price</b> |
| First Quarter       | 3,878         | \$ 24.01              |
| Second Quarter      | 6,817         | 28.95                 |
| Third Quarter       | 4,443         | 30.02                 |
| Fourth Quarter      | 2,438         | 30.55                 |
| Total Shares Issued | 17,576        |                       |

#### *2022 Preferred Stock Offering*

Following a Series A Preferred Stock Rights Offering to common shareholders, on November 9, 2022, the Bank issued 243,659 shares of 7.00% noncumulative, convertible, perpetual preferred stock at \$28.00 per share, or \$6,822,452 in gross proceeds. Net proceeds from the offering were \$6,642,261. The Bank intends to use the net proceeds from the offering to support future growth and for general corporate purposes.

The Series A Preferred Stock will pay a dividend of 7% per year, based on the initial subscription price of \$28.00 per share. The dividends will be paid quarterly at the sole discretion of the Bank's Board of Directors and are noncumulative. During any dividend period in which Series A Preferred Stock is outstanding, unless full dividends for the most recently completed dividend period on all outstanding Series A Preferred Stock have been declared and paid, no dividend will be declared or paid on the Bank's Common Stock.

The Series A Preferred Stock is nonvoting except with respect to any fundamental change in the terms of the preferred stock. These shares are convertible into Bank Common Stock no sooner than five years after delivery of the Series A

## Notes to Consolidated Financial Statements

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### **Note 17. Stockholders' Equity, continued**

#### ***2022 Preferred Stock Offering, continued***

Preferred Stock (November 9, 2022 ), and any time thereafter, at the sole discretion of the Bank's Board of Directors. The conversion, if it occurs, will be one share of Bank Common Stock for each share of Series A Preferred Stock held. With respect to the payment of dividends and distributions upon liquidation or dissolution, the Series A Preferred Stock will rank senior to the Bank's Common Stock.

#### ***2021 Stock Dividend***

On December 17, 2021 the Bank paid a ten percent common stock dividend to shareholders of record as of November 30, 2021. The dividend resulted in the issuance of 174,539 shares of common stock. No fractional shares were issued for book entry or street shares. Instead, the Bank provided a cash-in-lieu payment totaling \$6,505 for fractional shares based on a per share price of \$31.50, the undiscounted three-week volume weighted average price per share used in the November 19, 2021 calculation for DRIP purchases.

### **Note 18. Subsequent Events**

#### ***Property Acquisition***

On January 13, 2023, Bank of Botetourt purchased property located at 875 Tanyard Road in Rocky Mount, Virginia for a sales price of \$550,000. The Bank intends to file a branch application with its regulators after obtaining cost estimates for the project.

#### ***Declaration of Cash Dividend***

On January 31, 2023, the Bank declared a first quarter \$0.49 per preferred share paid on February 9, 2023 to preferred shareholders of record February 2, 2023.

On January 31, 2023, the Bank declared a first quarter \$0.1925 dividend per common share paid on February 17, 2023 to shareholders of record on February 13, 2023.

### **Note 19. Accounting Standards Updates**

In June 2016, the FASB issued ASU No. 2016-13, "*Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*," Under this ASU, the current incurred loss credit impairment methodology will be replaced with the CECL model, a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. Accordingly, the implementation of the CECL model will change the Bank's current method of providing an allowance for loan losses and may result in material changes in the Bank's accounting for credit losses on financial instruments. The CECL model may create more volatility in the Bank's estimate. If the Bank is required to materially increase its level of allowance for loan losses for any reason, such increase could adversely affect its business, financial condition, and results of operations. The FASB has issued multiple updates to ASU No. 2016-13 as codified in Topic 326, including ASU No. 2019-04, ASU No. 2019-05, ASU No. 2019-10, ASU No. 2019-11, ASU No. 2020-02, and ASU No. 2020-03. These ASUs have provided for various minor technical corrections and improvements to the codification as well as other transition matters. The new standard will be effective for the Bank beginning on January 1, 2023.

The amendments of ASC 326, upon adoption, will have the cumulative effect of adopting the new standard being recorded as an adjustment to opening retained earnings in the period of adoption. The Bank has engaged a third party vendor to gathered historical loan loss data for purposes of evaluating appropriate portfolio segmentation and modeling methods under the standard, performed procedures to validate the historical loan loss data to ensure its suitability and reliability for purposes of developing an estimate of expected credit losses under ASC 326, and is continuing to develop and refine an approach to estimating the allowance for credit losses. The adoption of ASC 326 will result in significant changes to the Bank's consolidated financial statements, which may include changes in the level of the allowance for credit losses that will be considered adequate, a reduction in total equity and regulatory capital of the

## Notes to Consolidated Financial Statements

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### **Note 19. Accounting Standards Updates, continued**

Bank, differences in the timing of recognizing changes to the allowance for credit losses and expanded disclosures about the allowance for credit losses. The Bank estimates that the effect of the change on retained earnings will be approximately \$580,000, of which approximately \$206,000 will be phased in over three year for calculating regulatory capital ratios. The adoption of the standard will also result in adjustments to the Bank's internal control over financial reporting related to the allowance for credit losses.

On October 20, 2020, the FDIC Board of Directors voted to issue an interim final rule to provide temporary relief from the Part 363 Audit and Reporting requirements for insured depository institutions that have experienced temporary growth due to participation in the PPP, PPPLF, MMLF, or other factors, such as other stimulus activities which caused many institutions to experience large cash inflows.

The interim final rule allowed institutions to determine whether they are subject to the requirements of Part 363 of the FDIC's regulations for fiscal years ending in 2021 based on the lesser of their (a) consolidated total assets as of December 31, 2019, or (b) consolidated total assets as of the beginning of their fiscal years ending in 2021. Currently, an institution determines if it is subject to the annual independent audit and reporting requirements of Part 363 based on its consolidated total assets as of the beginning of its fiscal year.

The intent of the interim final rule was to neutralize burdens that institutions may incur or have incurred because of temporary increases in their consolidated total assets resulting from participation in recent COVID-19-related stimulus activities, including the PPP, PPPLF, and MMLF, as the effort to develop processes and systems to comply with the requirements of Part 363 can be substantial. The FDIC in the interim final rule reserved the authority to require an institution to comply with one or more Part 363 requirements if the FDIC determines that asset growth was related to a merger or acquisition. Bank of Botetourt evaluated the interim rule and concluded that it met the criteria of the temporary regulatory relief for fiscal year ending in 2021. For fiscal year ending in 2022, requirements for Part 363 are applicable to the Bank.

Other accounting standards that have been issued by the FASB or other standards-setting bodies are not currently expected to have a material effect on the Company's financial position, results of operations or cash flows.



Bank of Botetourt

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