Touchstone Bankshares, Inc.

Audited Consolidated Financial Statements

December 31, 2023

Forward-Looking Statements

This report contains forward-looking statements with respect to Touchstone Bankshares, Inc.'s financial condition, results of operations and business. These forward-looking statements involve certain risks and uncertainties. When used in this report, in press releases or other public shareholder communications, or in oral statements made with the approval of an authorized executive officer, the words or phrases "will likely result," "are expected to," "will continue," "is anticipated," "estimate," "project," "believe," or similar expressions are intended to identify "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. We caution the readers and users of this information not to place undue reliance on any such forward-looking statements, which speak only as of the date made, and advise readers that various factors including regional and national economic conditions, changes in the levels of market rates of interest, credit risk and lending activities, and competitive and regulatory factors could affect the financial performance of Touchstone Bankshares, Inc. and could cause actual results for future periods to differ materially from those anticipated or projected. Touchstone Bankshares, Inc. does not undertake and specifically disclaims any obligation to publicly release the result of any revisions which may be made to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

Selected Financial Data

The summary financial data should be read in conjunction with the historical financial statements and the notes thereto included elsewhere in this document.

	Year Ended December 31,				
	2023	2022	2021	2020	2019
	(Dollars in thousands, except per share information)				
Income Statement Data:					
Interest income	$ 29,472	$ 23,078	$ 21,011	$ 20,949	$ 20,552
Interest expense	8,623	2,479	2,208	3,092	3,406
Net interest income	$ 20,849	$ 20,599	$ 18,803	$ 17,857	$ 17,146
Provision for credit losses	978	605	-	2,250	63
Noninterest income	3,507	3,567	3,863	2,884	3,091
Noninterest expense	21,532	19,002	17,196	15,767	16,145
Income taxes	238	509	1,022	435	743
Net income (1)	$ 1,608	$ 4,050	$ 4,448	$ 2,289	$ 3,286
Per Share and Shares Outstanding Data:					
Basic earnings per share	$ 0.49	$ 1.24	$ 1.33	$ 0.69	$ 0.99
Fully diluted earnings per share	0.49	1.24	1.33	0.68	0.98
Cash dividends declared	0.32	0.32	0.30	0.28	0.28
Book value per common share at period end	13.68	13.12	15.57	15.01	14.18
Tangible book value per common share	13.57	12.94	15.32	14.68	13.75
Common shares outstanding at period end	3,270,676	3,246,236	3,265,615	3,334,445	3,325,043
Average shares outstanding, basic	3,240,529	3,249,248	3,326,511	3,326,507	3,320,989
Average shares outstanding, diluted	3,269,677	3,278,396	3,355,659	3,355,786	3,350,367
Balance Sheet Data:					
Total assets	$ 658,695	$ 622,608	$ 581,136	$ 532,732	$ 468,189
Total investment securities	73,170	76,350	95,106	93,875	62,974
Total loans, net	503,831	482,335	398,535	358,672	347,996
Total deposits	542,239	526,553	517,396	445,774	382,924
Total borrowed funds (including subordinated debt)	66,731	48,621	7,825	32,282	33,542
Shareholders' equity	44,809	42,647	50,896	50,124	47,219
Performance Ratios:					
Return on average assets	0.25%	0.67%	0.77%	0.45%	0.72%
Return on average equity	3.73%	8.88%	8.70%	4.65%	6.90%
Net interest margin (2)	3.56%	3.67%	3.52%	3.86%	4.14%
Asset Quality Ratios:					
Allowance to period-end loans	0.98%	1.00%	1.09%	1.20%	0.65%
Non-performing assets to total assets(3)	0.05%	0.07%	0.05%	0.49%	0.43%
Capital Ratio:					
Community Bank/Tier 1 leverage ratio(4)	9.68%	10.13%	9.27%	9.63%	9.61%

(1) Excludes effective dividends for preferred stock.
(2) Net interest income divided by total average-earning assets.
(3) Non-performing assets consist of nonaccrual loans, loans more than 90 days past due and accruing and foreclosed properties.
(4) In 2020, Touchstone Bank adopted the Community Bank Leverage Ratio.

BROWNEDWARDS
certified public accountants

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and Shareholders of
Touchstone Bankshares, Inc.
Prince George, Virginia

Opinion

We have audited the accompanying consolidated financial statements of Touchstone Bankshares Inc. and Subsidiary (the "Company"), which comprise the consolidated balance sheets as of December 31, 2023 and 2022, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Touchstone Bankshares, Inc. and Subsidiary as of December 31, 2023 and 2022, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Change in Accounting Principle

As discussed in Note 1 to the consolidated financial statements, the Company has changed its method of accounting for credit losses effective January 1, 2023 due to the adoption of Financial Accounting Standards Board (FASB) Accounting Standards Codification No. 326, *Financial Instruments – Credit Losses (ASC 326)*. The Company adopted the new credit loss standard using the modified retrospective method such that prior period amounts are not adjusted and continue to be reported in accordance with previously applicable generally accepted accounting principles.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of Touchstone Bankshares Inc. 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.

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Responsibilities of Management for the Consolidated Financial Statements (Continued)

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 Touchstone Bankshares Inc. and Subsidiary's ability to continue as a going concern within one year after 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 generally accepted auditing standards 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, including omissions, are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with generally accepted auditing standards, 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 Touchstone Bankshares Inc. 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 Touchstone Bankshares Inc. 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.

Other Information Included in the Annual Report

Management is responsible for the other information included in the annual report. The other information comprises management's five-year financial summary (unaudited) included in the annual report but does not include the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information, and we do not express an opinion or any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and consider whether a material inconsistency exists between the other information and the financial statements, or the other information otherwise appears to be materially misstated. If, based on the work performed, we conclude that an uncorrected material misstatement of the other information exists, we are required to describe it in our report.

Brown, Edwards & Company, L.L.P.

CERTIFIED PUBLIC ACCOUNTANTS

Christiansburg, Virginia
April 29, 2024

TOUCHSTONE BANKSHARES, INC.
Consolidated Balance Sheets
December 31, 2023 and 2022
(in thousands, except shares and per share data)

	2023	2022
Assets		
Cash and due from Banks	$ 22,526	$ 11,756
Federal funds sold	18,681	11,845
Interest-bearing time deposits in Banks	1,109	1,354
Securities available for sale, at fair value	73,170	76,350
Restricted equity securities	4,037	2,754
Loans, net of allowance for credit losses of $4,979 in 2023 and $4,881 in 2022	503,831	482,335
Land, premises and equipment, net	11,309	11,819
Accrued interest receivable	1,928	1,729
Bank-owned life insurance	12,406	12,046
Core deposit intangible, net	369	570
Other assets	9,329	10,050
Total assets	$ 658,695	$ 622,608
Liabilities and Shareholders' Equity		
Liabilities		
Deposits:		
Noninterest-bearing	$ 137,253	$ 136,779
Interest-bearing	404,986	389,774
Total deposits	542,239	526,553
Federal Home Loan Bank advances	49,000	31,000
Subordinated debt, net of issuance costs	17,731	17,621
Accrued interest payable	1,181	493
Accrued expenses and other liabilities	3,735	4,294
Total liabilities	613,886	579,961
Commitments and contingencies		
Shareholders' Equity		
Preferred stock, $2 par value, authorized 500,000 shares; issued and outstanding 29,148 in 2023 and 2022	58	58
Common stock, $2 par value, authorized 10,000,000 shares; issued and outstanding 3,270,676 in 2023 and 3,246,236 in 2022 (includes 26,562 and 27,830 of unvested shares in 2023 and 2022, respectively)	6,541	6,493
Surplus	20,058	19,884
Retained earnings	27,720	27,187
Accumulated other comprehensive loss, net	(9,568)	(10,975)
Total shareholders' equity	44,809	42,647
Total liabilities and shareholders' equity	$ 658,695	$ 622,608

See Notes to Consolidated Financial Statements

TOUCHSTONE BANKSHARES, INC.
Consolidated Statements of Income
For the Years Ended December 31, 2023 and 2022
(in thousands, except shares and per share data)

	2023	2022
Interest and Dividend Income		
Interest and fees on loans	$ 25,935	$ 20,599
Interest and dividends on securities − taxable	1,888	1,758
Interest on securities − nontaxable	323	417
Interest on deposits in Banks	640	150
Interest on federal funds sold	686	154
Total interest and dividend income	29,472	23,078
Interest Expense		
Interest on deposits	5,753	1,365
Interest on borrowed funds	2,870	1,114
Total interest expense	8,623	2,479
Net interest income	20,849	20,599
Provision for credit losses	978	605
Net interest income after provision for credit losses	19,871	19,994
Noninterest Income		
Service charges on deposit accounts	1,937	2,046
Secondary market origination fees	258	184
Bank-owned life insurance	309	643
(Loss) on sale of securities available for sale	-	(135)
(Loss) on sale of fixed assets	-	(90)
Other operating income	1,003	919
Total noninterest income	3,507	3,567
Noninterest Expense		
Salaries and employee benefits	11,699	10,564
Occupancy expense	1,249	1,263
Furniture and equipment expense	1,118	1,165
Data processing	1,389	624
Telecommunications	604	777
Legal and professional fees	777	812
(Gains) on other real estate owned	(23)	-
FDIC assessments	366	220
Corporate franchise tax	476	412
Other operating expenses	3,877	3,165
Total noninterest expenses	21,532	19,002
Income before income taxes	1,846	4,559
Income tax expense	238	509
Net income	1,608	4,050
Dividends declared on preferred stock	9	9
Income available to common shareholders	$ 1,599	$ 4,041
Earnings per Common Share		
Basic earnings per common share	$ 0.49	$ 1.24
Diluted earnings per common share	$ 0.49	$ 1.24
Basic weighted average shares outstanding	3,240,529	3,249,248
Diluted weighted average shares outstanding	3,269,677	3,278,396

See Notes to Consolidated Financial Statements

TOUCHSTONE BANKSHARES, INC.
Consolidated Statements of Comprehensive Income (Loss)
For the Years Ended December 31, 2023 and 2022
(in thousands)

	2023	2022
Net income	$ 1,608	$ 4,050
Other comprehensive income (loss):		
Change in unrealized holding gains (losses) on securities available for sale	1,781	(13,921)
Tax effect related to unrealized holding (gains) losses	(374)	2,923
Reclassification of net realized losses in securities sold	-	135
Tax effect related to net realized losses in securities sold	-	(28)
Other comprehensive income (loss)	1,407	(10,891)
Total comprehensive income (loss)	$ 3,015	$ (6,841)

See Notes to Consolidated Financial Statements

TOUCHSTONE BANKSHARES, INC.
Consolidated Statements of Changes in Shareholders' Equity
For the Years Ended December 31, 2023 and 2022
(in thousands, except for per share data)

	Preferred Stock	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance at December 31, 2021	$ 58	$ 6,531	$ 20,206	$ 24,185	$ (84)	$ 50,896
Net income	-	-	-	4,050	-	4,050
Other comprehensive loss	-	-	-	-	(10,891)	(10,891)
Shares issued	-	65	(65)	-	-	-
Purchases of common stock	-	(103)	(493)	-	-	(596)
Stock-based compensation	-	-	236	-	-	236
Cash dividends declared- ($0.32 per common & preferred share)	-	-	-	(1,048)	-	(1,048)
Balance at December 31, 2022	$ 58	$ 6,493	$ 19,884	$ 27,187	$ (10,975)	$ 42,647
Cumulative effect adjustment due to the adoption of ASU 2016-13	-	-	-	(20)	-	(20)
Net income	-	-	-	1,608	-	1,608
Other comprehensive income	-	-	-	-	1,407	1,407
Shares issued	-	48	(48)	-	-	-
Stock-based compensation	-	-	222	-	-	222
Cash dividends declared- ($0.32 per common & preferred share)	-	-	-	(1,055)	-	(1,055)
Balance at December 31, 2023	$ 58	$ 6,541	$ 20,058	$ 27,720	$ (9,568)	$ 44,809

See Notes to Consolidated Financial Statements

TOUCHSTONE BANKSHARES, INC.
Consolidated Statements of Cash Flows
For the Years Ended December 31, 2023 and 2022
(in thousands)

	2023	2022
Cash Flows from Operating Activities		
Net income	$ 1,608	$ 4,050
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	878	921
Provision for credit losses	978	605
Stock-based compensation expense	222	236
Net accretion of certain acquisition-related fair value adjustments	(139)	(87)
Amortization of core deposit intangible	201	245
Net amortization of premiums on securities available for sale	407	528
Originations of loans held for sale	(1,025)	(4,360)
Proceeds from sale of loans held for sale	1,283	4,544
Secondary market origination fees	(258)	(184)
Income from bank-owned life insurance	(360)	(113)
Loss on sale of securities available for sale	-	135
Loss on sale of fixed assets	-	90
Gain on sale of other real estate owned	(23)	-
Deferred tax benefit	(55)	(223)
Changes in assets and liabilities:		
Accrued interest receivable	(199)	113
Other assets	407	(953)
Accrued interest payable	688	229
Accrued expenses and other liabilities	(591)	(803)
Net cash provided by operating activities	4,022	4,973
Cash Flows from Investing Activities		
Redemption of interest-bearing time deposits in banks	245	249
Proceeds from sales of securities available for sale	206	6,076
Maturities, prepayments and calls of securities available for sale	3,792	7,539
Purchases of securities available for sale	(247)	(9,330)
Purchases of restricted equity securities	(1,283)	(1,423)
Net increase in loans	(21,439)	(84,212)
Purchases of land, premises and equipment	(368)	(609)
Proceeds from sales of land, premises and equipment	-	167
Proceeds from sales of other real estate owned	40	-
Net cash used in investing activities	(19,054)	(81,543)
Cash Flows from Financing Activities		
Net increase (decrease) in noninterest-bearing deposits	474	(34,306)
Net increase in interest-bearing deposits	15,212	43,463
Dividends paid	(1,048)	(988)
Repurchases of common stock	-	(596)
Proceeds from issuance of subordinated debt, net of issuance costs	-	9,690
Increase in Federal Home Loan Bank advances and other borrowed funds	18,000	31,000
Net cash provided by financing activities	32,638	48,263
Net increase (decrease) in cash and cash equivalents	17,606	(28,307)
Cash and cash equivalents - beginning of year	23,601	51,908
Cash and cash equivalents - end of year	$ 41,207	$ 23,601

See Notes to Consolidated Financial Statements

TOUCHSTONE BANKSHARES, INC.
Consolidated Statements of Cash Flows
For the Years Ended December 31, 2023 and 2022
(in thousands)

	2023	2022
Supplemental Disclosures of Cash Flow Information		
Cash paid for:		
Interest	$ 7,935	$ 2,250
Income taxes	165	1,352
Non-cash investing and financing activities:		
Unrealized gain (loss) on securities available for sale	$ 1,781	$ (13,786)
Loans converted to other real estate owned	17	-
Cumulative effect adjustment due to the adoption of ASU 2016-13	(20)	-

See Notes to Consolidated Financial Statements

Note 1. Organization and Summary of Significant Accounting Policies

Organization

On November 10, 2017, Bank of McKenney acquired CCB Bankshares, Inc. (“CCB”) in a business combination and merger of the two companies. Upon completion of the merger, banking operations of both institutions were consolidated and reorganized under the name Touchstone Bank (the “Bank”). The Bank provides depository and lending services for customers primarily within the counties of Dinwiddie, Chesterfield and Prince George, Virginia and the cities of Colonial Heights, Hopewell and Petersburg, Virginia. After the acquisition of CCB, the Bank’s market area has expanded to include those customers previously within CCB’s geographic footprint, which is focused primarily along the central Virginia-North Carolina border.

In July of 2020, the Bank formed a bank holding company -- Touchstone Bankshares, Inc. (the “Company”). The formation of the Company was finalized on July 1, 2020, with a one-for-one share exchange of the Bank’s preferred and common shares with the Company’s preferred and common shares, respectively.

The Company is subject to competition from other financial institutions. The Company is also subject to the regulations of the Board of Governors of the Federal Reserve System (the “Federal Reserve”) and the State Corporation Commission of Virginia (the “SCC”), and it undergoes periodic examinations by these regulatory authorities.

McKenney Group, LLC (“McKenney”) is a wholly owned subsidiary of the Bank formed in December of 2000 to provide networking solutions to Virginia community banks. Since its inception, its focus has evolved into a wider array of financial services. McKenney maintains investments in Bankers Title, LLC and Bankers Insurance, LLC. Early in the second quarter of 2023, the Company partnered with Appomattox Wealth Management (“Appomattox”) to provide access to brokerage business including financial advisory services for its existing clients. Appomattox, which is headquartered in Chester, Virginia with an additional office in Dinwiddie, Virginia, leverages LPL Financial LLC’s wealth management platform to provide a wide array of financial services for businesses and individuals, including financial planning, investment management, retirement income planning, estate planning, and insurance.

The Company has issued and outstanding preferred and common stock. Preferred shares pay dividends annually at a per share rate equal to that declared on common shares and have a conversion feature that permits the preferred shares to be converted into common shares on a one-to-one basis if the holder also holds share(s) of common stock in the Company. Preferred shareholders are not entitled to vote for directors during annual elections, however, the class has voting rights on issues pertaining to any change of control.

The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America (“U.S. GAAP”) and predominant practices within the Company’s industry. The following is a description of the more significant of these policies.

Critical Accounting Policies

Management believes the policies with respect to the methodology for the determination of the allowance for credit losses, and asset impairment judgments, such as the recoverability of intangible assets and credit losses on investment securities and loans, involve a higher degree of complexity and require management to make difficult and subjective judgments that often require assumptions or estimates about highly uncertain matters. Changes in these judgments, assumptions or estimates could cause reported results to differ materially.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company, the Company's wholly owned subsidiary, the Bank, and the Bank's wholly owned subsidiary McKenney. All material intercompany balances and transactions have been eliminated in consolidation.

Business Segments

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

Business Combinations

Generally, acquisitions are accounted for under the acquisition method of accounting in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 805, *Business Combinations*. A business combination occurs when the Company acquires net assets that constitute a business or acquires equity interests in one or more other entities that are businesses and obtains control over those entities. Business combinations are effected through the transfer of consideration consisting of cash and/or common stock and are accounted for using the acquisition method. Accordingly, the assets and liabilities of the acquired entity are recorded at their respective fair values as of the closing date of the acquisition. Determining the fair value of assets and liabilities, especially the loan portfolio, is a complicated process involving significant judgment regarding methods and assumptions used to calculate estimated fair values. Fair values are subject to refinement for up to one year after the closing date of the acquisition as information relative to closing date fair values becomes available. The results of operations of an acquired entity are included in consolidated results from the closing date of the merger, and prior periods are not restated.

Use of Estimates

In preparing consolidated financial statements in conformity with U.S. GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates. Material estimates particularly susceptible to significant change in the near term relate to determination of the allowance for credit losses, loans acquired in a business combination, valuation of other real estate owned ("OREO") and deferred tax assets.

Substantially all of the Company's loan portfolio consists of loans in its market area. Accordingly, the ultimate collectability of a substantial portion of the Company'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. The regional economy is diverse but influenced to an extent by the manufacturing and agricultural segments.

While management uses available information to recognize loan and foreclosed real estate losses, future additions to the allowances may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as a part of their routine examination process, periodically review the Company's allowances for credit and foreclosed real estate losses. Such agencies may require the Company to recognize additions to the allowances 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 allowances for credit and foreclosed real estate losses may change materially in the near term.

The Company seeks strategies that minimize the tax effect of implementing their business strategies. As such, judgments are made regarding the ultimate consequence of long-term tax planning strategies, including the likelihood of future recognition of deferred tax benefits. The Company's tax returns are subject to examination by both Federal and State authorities. Such examinations may result in the assessment of additional taxes, interest, and penalties. As a result, the ultimate outcome, and the corresponding financial statement impact, can be difficult to predict with accuracy.

Cash and Cash Equivalents

For purposes of the statements of cash flows, cash and cash equivalents include cash, due from banks and federal funds sold. Generally, federal funds are sold for one-day periods. Due from banks may include interest-bearing demand deposits. The Bank had historically been required to maintain cash reserve balances on hand or with the Federal Reserve Bank of Richmond (the “FRB”). At December 31, 2023, and 2022, there was no minimum reserve requirement as a result of a rule adopted by the FRB in March 2020 eliminating the reserve requirement.

Investment Securities

Debt investment securities that management has the positive intent and ability to hold to maturity are classified as “held to maturity” (“HTM”) and are recorded at amortized cost. Investment securities held principally for the purpose of being sold in the near future (thus held for only a short period of time) are classified as trading and are recorded at fair value, with unrealized gains and losses reported in earnings. Investment securities not classified as HTM or trading, are classified as “available for sale” (“AFS”) and are recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income (loss), net of tax. Purchased premiums and discounts are recognized in interest income using the interest method over the terms of the investment securities. Realized gains or losses on AFS investment securities are computed on the specific identification basis.

Loans Held for Sale

Loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or fair value. Mortgage loans held for sale are sold with the mortgage servicing rights released by the Company. The Company enters into commitments to originate certain mortgage loans whereby the interest rate on the loans is determined prior to funding (rate lock commitments). Rate lock commitments on mortgage loans that are intended to be sold are considered to be derivatives. The period of time between issuance of a loan commitment, loan closing and the sale of the loan generally ranges from thirty (30) to ninety (90) days. The Company protects itself from changes in interest rates through the use of best efforts forward delivery commitments, whereby the Company commits to sell a loan at the time the borrower commits to an interest rate with the intent that the buyer has assumed interest rate risk on the loan. As a result, the Company is not exposed to losses, nor will it realize significant gains related to its rate lock commitments due to changes in interest rates. The correlation between the rate lock commitments and best-efforts contracts is very high due to their similarity. Because of this high correlation, no gain or loss occurs on the rate lock commitments. The Company had no loans held for sale at December 31, 2023, or 2022.

Restricted Equity Securities

The Company is required to maintain an investment in the capital stock of the FRB, Community Bankers' Bank (“CBB”) and the Federal Home Loan Bank of Atlanta (“FHLB”). No ready market exists for these stocks, and they have no quoted market value. The Company's investment in these stocks is recorded at cost.

Accounting Standards Adopted in 2023

On January 1, 2023, the Company adopted Accounting Standards Update (“ASU”) 2016-13 *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* (“ASC 326”). This standard replaced the incurred loss methodology with an expected loss methodology that is referred to as the current expected credit loss (“CECL”) methodology. CECL requires an estimate of credit losses for the remaining estimated life of the financial asset using historical experience, current conditions, and reasonable and supportable forecasts and generally applies to financial assets measured at amortized cost, including loan receivables and HTM debt investment securities, and some off-balance sheet credit exposures such as unfunded commitments to extend credit. Financial assets measured at amortized cost will be presented at the net amount expected to be collected by using an allowance for credit losses. Purchased credit deteriorated ("PCD") loans will receive an initial allowance for credit losses at the acquisition date that represents an adjustment to the amortized cost basis of the loan, with no impact to earnings.

In addition, CECL made changes to the accounting for AFS debt investment securities. One such change is to require credit losses to be presented as an allowance rather than as a write-down on AFS debt investment securities if management does not intend to sell and does not believe that it is more likely than not they will be required to sell.

The Company adopted ASC 326 and all related subsequent amendments thereto effective January 1, 2023, using the modified retrospective approach for all financial assets measured at amortized cost and off-balance sheet credit exposures. The transition adjustment of the adoption of CECL resulted in no change in the allowance for credit losses on loans, which is presented as a reduction to net loans outstanding, and an increase in the allowance for credit losses on unfunded loan commitments of $25 thousand, which is recorded within "Accrued expenses and other liabilities" on the consolidated balance sheets. The Company recorded a net decrease to retained earnings of $20 thousand as of January 1, 2023, for the cumulative effect of adopting CECL, which reflects the transition adjustments noted above, net of the applicable deferred tax assets recorded. Results for reporting periods beginning after January 1, 2023, are presented under the CECL methodology while prior period amounts continue to be reported in accordance with previously applicable accounting standards ("Incurred Loss").

The Company adopted ASC 326 using the prospective transition approach for PCD assets that were previously classified as purchased credit impaired ("PCI") under ASC 310-30. In accordance with the standard, management did not reassess whether PCI assets met the criteria of PCD assets as of the date of adoption. On January 1, 2023, there was no adjustment made to the amortized cost basis of PCD assets to establish the allowance for credit losses on loans. The remaining interest-related discount of approximately $155 thousand will be accredited into interest income at the effective interest rate as of January 1, 2023.

Regarding PCD assets, the Company elected to disaggregate the former PCI pools and no longer considers these pools to be the unit of account; contractually delinquent PCD loans will be reported as nonaccrual loans using the same criteria as other loans.

The Company adopted ASC 326 using the prospective transition approach for debt investment securities for which other-than-temporary impairment ("OTTI") had been recognized prior to January 1, 2023. As of December 31, 2022, the Company did not have any OTTI debt investment securities. Therefore, upon adoption of ASC 326, the Company determined that an allowance for credit losses on AFS debt investment securities was not deemed necessary.

The Company elected not to measure an allowance for credit losses for accrued interest receivable and instead elected to reverse interest income on loans or investment securities that are placed on nonaccrual status, which is generally when the instrument is ninety (90) days past due, or earlier if the Company believes the collection of interest is doubtful. The Company has concluded that this policy results in the timely reversal of uncollectible interest.

The allowance for credit losses is established as losses are estimated to have occurred through a provision for credit losses charged to earnings. Loan losses are charged against the allowance for credit losses when management believes the loan balance, or a portion thereof, is uncollectable. Subsequent recoveries, if any, are credited to the allowance for credit losses.

The allowance for credit 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, which includes forecasted future economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The adoption of ASC 326 eliminated the accounting guidance for troubled debt restructurings ("TDRs") by creditors and enhanced the disclosure requirements for loan refinancings and restructurings made with borrowers experiencing financial difficulty. For information related to modifications made to borrowers experiencing financial difficulty after the adoption of ASC 326 and information regarding TDRs before the adoption of ASC 326, see Notes 3 and 4 to the consolidated financial statements.

Allowance for Credit Losses – Available for Sale Investment Securities

For AFS investment securities, management evaluates all investment securities in an unrealized loss position on a quarterly basis, and more frequently when economic or market conditions warrant such evaluation. If the Company has the intent to sell the investment security, or it is more likely than not that the Company will be required to sell the investment security, the investment security is written down to fair value, and the entire loss is recorded in earnings.

If either of the above criteria is not met, the Company evaluates whether the decline in fair value is the result of credit losses or other factors. In making the assessment, the Company may consider various factors including the extent to which fair value is less than amortized cost, performance on any underlying collateral, downgrades in the ratings of the investment security by a rating agency, the failure of the issuer to make scheduled interest or principal payments and adverse conditions specifically related to the investment security. If the assessment indicates that a credit loss exists, the present value of cash flows expected to be collected is compared to the amortized cost basis of the investment security and any excess is recorded as an allowance for credit losses, limited to the amount that the fair value is less than the amortized cost basis. Any amount of unrealized loss that has not been recorded through an allowance for credit losses is recognized in other comprehensive income.

Changes in the allowance for credit losses are recorded as a provision for (or reversal of) credit loss expense. Losses are charged against the allowance for credit losses when management believes an AFS investment security is confirmed to be uncollectible or when either of the criteria regarding intent or requirement to sell is met. At December 31, 2023, there was no allowance for credit losses related to the AFS investment securities portfolio.

Accrued interest receivable on AFS debt investment securities, which is reported in "Accrued interest receivable" on the consolidated balance sheets, totaled $578 thousand at December 31, 2023, and was excluded from the estimate of credit losses.

Loans

The Company generates commercial and residential real estate, commercial, construction, and consumer loans to customers. A substantial portion of the loan portfolio is represented by commercial and consumer loans secured by real estate. The ability of the Company's debtors to honor their contracts is dependent upon general economic conditions and real estate values in the Company's market area.

Loans the Company has the intent and ability to hold for the foreseeable future, until maturity or pay-off generally are reported at their outstanding unpaid principal balances adjusted for deferred costs and fees and the allowance for credit losses. Interest income is accrued on the unpaid principal balance.

The accrual of interest on mortgage and commercial loans is discontinued at the time the loan is ninety (90) days or more past due unless the credit is well secured and in process of collection. Installment loans are typically charged off no later than one hundred eighty (180) days past due. All loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful. Past due status is based on contractual terms of the loan. A loan is considered to be past due when a scheduled payment has not been received thirty (30) days after the contractual due date.

All interest accrued but not collected for loans placed on nonaccrual or charged off, is reversed against interest income. The interest on these loans is accounted for on the cash basis or cost recovery method, until qualifying for return to accrual status. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Purchased Credit Deteriorated Loans

Upon adoption of ASC 326, loans that were designated as PCI loans under the previous accounting guidance were classified as PCD loans without reassessment.

In future acquisitions, the Company may purchase loans, some of which have experienced more than insignificant credit deterioration since origination. In those cases, the Company will consider internal loan grades, delinquency status, and other relevant factors in assessing whether purchased loans are PCD. PCD loans are recorded at the amount paid. An initial allowance for credit losses is determined using the same methodology as other loans held for investment, but with no impact to earnings. The initial allowance for credit losses determined on a collective basis is allocated to individual loans. The sum of the loan's purchase price and allowance for credit losses becomes its initial amortized cost basis. The difference between the initial amortized cost basis and the par value of the loan is a noncredit discount or premium, which is amortized into interest income over the life of the loan. Subsequent to initial recognition, PCD loans are subject to the same interest income recognition and impairment model as non-PCD loans, with changes to the allowance for credit losses recorded through a provision for credit loss expense.

Allowance for Credit Losses - Loans

The allowance for credit losses for loans is a valuation account that is deducted from the loans' amortized cost basis to present the net amount expected to be collected on the loans. The allowance for credit losses is established, as losses are estimated to have occurred, through a provision for credit losses charged to earnings. Loans are charged off against the allowance for credit losses when management believes the uncollectibility of a loan balance is confirmed. Expected recoveries do not exceed the aggregate of amounts previously charged off and expected to be charged off. Accrued interest receivable is excluded from the estimate of credit losses.

The allowance for credit losses represents management's estimate of lifetime credit losses inherent in loans as of the balance sheet date. The allowance for credit losses is estimated by management using relevant available information, from both internal and external sources, relating to past events, current conditions, and reasonable and supportable forecasts.

The Company measures expected credit losses for loans on a pooled basis when similar risk characteristics exist. The Company has identified the loan portfolio segmentation by FFIEC Call Report loan codes and calculates the allowance for credit losses for each using a Lifetime of Probability of Default / Loss Given Default ("Lifetime PD/LGD") methodology because of the historical loss information the Company has on its loan portfolio, which is less subjective in nature, than the other methodologies available. For loan portfolio segmentations that have no or very minimal historical loss information to derive a Lifetime PD/LGD, a similar loan portfolio segmentation Lifetime PD/LGD (i.e. link Lifetime PD/LGD) is used until enough historical loss information is observed. Under this methodology an estimate of probability of default and a lifetime loss rate is applied to the portfolio segment based on the loss history during the economic life cycle of these type of loans.

Additionally, the allowance for credit losses calculation includes subjective adjustments for qualitative risk factors that are likely to cause estimated credit losses to differ from historical experience. These qualitative adjustments may increase or reduce reserve levels and include adjustments for: the Company's lending policies and procedures, including changes in underwriting standards and practices for collections, write-offs, and recoveries; actual and expected changes in international, national, regional, and local economic and business conditions and developments in which the Company operates that affect the collectability of financial assets; the nature and volume of the Company's financial assets; the experience, ability, and depth of the Company's lending, investment, collection, and other relevant management and staff; the existence, growth, and effect of any concentrations of credit; changes in volume and severity of adversely graded loans; changes in interest rates; and declining values in a recessionary economy. The qualitative risk factor adjustments are applied to each loan portfolio segmentation at a global level except for "changes in volume and severity of adversely graded loans", which is applied specifically to watch and special mention credits. The Company has designated Real GDP growth, national and state unemployment rates, and the charge off rate on loans secured by real estate for all commercial banks as its forecast variables for a period of twelve (12) months. These forecasts from reputable and independent third parties are sourced to inform the Company's reasonable and supportable forecasting of current expected credit losses.

Loans that do not share risk characteristics are evaluated on an individual basis. When management determines that foreclosure is probable and the borrower is experiencing financial difficulty, the expected credit losses are based on the fair value of collateral at the reporting date and adjusted for selling costs as appropriate.

The allowance for credit losses is evaluated on a regular basis by management and is based upon 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. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available. During these evaluations, particular characteristics associated with a segment of the loan portfolio are also considered. These characteristics are detailed below:

- Commercial loans not secured by real estate carry risks associated with the successful operation of a business, and the repayments of these loans depend on the profitability and cash flows of the business. Additional risk relates to the value of collateral where depreciation occurs, and the valuation is less precise. Commercial loans are included in the "Other" loan category in Notes 3 and 4 to the consolidated financial statements.
- Loans secured by commercial real estate also carry risks associated with the success of the business and the ability to generate a positive cash flow sufficient to service debts. Real estate security diminishes risks only to the extent that a market exists for the subject collateral.
- Consumer loans carry risks associated with the continued creditworthiness of the borrower and the value of the collateral, such as automobiles which may depreciate more rapidly than other assets. In addition, these loans may be unsecured. Consumer loans are more likely than real estate loans to be immediately affected in an adverse manner by job loss, divorce, illness, or personal Bankruptcy. Consumer loans are included in the "Other" loan category in Notes 3 and 4 to the consolidated financial statements.
- Real estate secured construction loans carry risks that a project will not be completed as scheduled and/or budgeted and that the value of the collateral may, at any point, be less than the principal amount of the loan. Additional risks may occur if the general contractor, who may not be a loan customer, is unable to finish the project as planned due to financial pressures unrelated to the project.
- Residential real estate loans carry risks associated with the continued credit worthiness of the borrower and changes in the value of the collateral.

The primary tool used in managing and controlling problem loans is a watch list report. The report is a listing of all loans or commitments that are either demonstrating signs of becoming problematic or are currently considered problem loans.

Occurrence of any of the following criteria is a basis for adding a loan to the watch list report.

- Loans classified as watch, substandard, doubtful or loss by management, Company examiners, external auditors, or external loan review.
- Loans more than sixty (60) days delinquent.
- Loans renewed or extended more than two (2) times with little or no principal curtailment.
- Loans judgmentally selected by management or the Board of Directors due to unexpected changes or events which could have a potentially adverse effect on the borrower's ability to repay.

When a loan is added to the watch list report, the loan is assessed to determine whether it should be individually evaluated. Watch list loans are reviewed at least quarterly to determine if they should be individually evaluated. If the loan is determined to be individually evaluated, updated valuations are required, and the loan grade is adjusted accordingly. Upon receipt of current value updates, management will estimate the need for a specific reserve to be recognized in the Company's allowance for credit losses.

The allowance for credit losses consists of specific, general, and unallocated components. The specific component relates to loans classified as individually evaluated loans. For such loans an allowance for credit losses is established when the net collateral value (or discounted cash flows or observable market price) of the loan is lower than the carrying value of that loan.

The general component covers collectively evaluated loans and is based on historical loss experience using a Lifetime PD/LGD methodology adjusted for qualitative risk factors including: the Company's lending policies and procedures, including changes in underwriting standards and practices for collections, write-offs, and recoveries; actual and expected changes in international, national, regional, and local economic and business conditions and developments in which the Company operates that affect the collectability of financial assets; the nature and volume of the Company's financial assets; the experience, ability, and depth of the Company's lending, investment, collection, and other relevant management and staff; the existence, growth, and effect of any concentrations of credit; changes in volume and severity of adversely graded loans; changes in interest rates; and declining values in a recessionary economy. An unallocated component may be maintained to cover uncertainties that could affect management's estimate of expected losses.

The Company utilizes a risk grading matrix to assign a risk grade to each of its loans. Credits are graded on a scale of 1 to 9. A description of the general characteristics of the risk grades is as follows:

- Risk rated 1 loans have little or no risk and are generally secured by cash or cash equivalents;
- Risk rated 2 loans have minimal risk to well qualified borrowers and no significant questions as to safety;
- Risk rated 3 loans are satisfactory loans with strong borrowers and secondary sources of repayment;
- Risk rated 4 loans are satisfactory loans with borrowers not as strong as risk rated 3 loans and may exhibit a greater degree of financial risk based on the type of business supporting the loan;
- Risk rated 5 loans are watch loans that warrant more than the normal level of supervision and have the possibility of an event occurring that may weaken the borrower's ability to repay;
- Risk rated 6 loans are special mention loans and have increasing potential weaknesses beyond those at which the loan originally was granted and if not addressed could lead to inadequately protecting the Company's credit position;
- Risk rated 7 loans are substandard loans and are inadequately protected by the current sound worth or paying capacity of the obligor or the collateral pledged; these have well defined weaknesses that jeopardize the liquidation of the debt with the distinct possibility the Company will sustain some loss if the deficiencies are not corrected;
- Risk rated 8 loans are doubtful of collection and the possibility of loss is high but pending specific borrower plans for recovery, its classification as a loss is deferred until its more exact status is determined; and

- Risk rated 9 loans are loss loans which are considered uncollectable and of such little value that their continuance as bankable assets is not warranted.

All classes of loans, except consumer loans, are individually evaluated when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. The need for a specific reserve is measured on a loan by loan basis for commercial, commercial real estate, residential real estate, 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 net fair value of the collateral if the loan is collateral dependent. Large groups of smaller balance homogeneous loans are collectively evaluated. Loans with a balance of less than $100 thousand are generally not individually evaluated and are included in loans collectively evaluated.

Accordingly, the Company does not separately identify individual consumer loans to be individually evaluated unless they are part of a modification made to a borrower experiencing financial difficulty. In connection with the evaluation of the collectability of all classes of loans which are greater than ninety (90) days past due as to principal or interest for nonaccrual status, any amounts not deemed well secured or otherwise collectible shall be charged off at that time. It is the policy of the Company to charge off amounts deemed uncollectible in the periods when identified.

Allowance for Credit Losses – Unfunded Commitments

Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit issued to meet customer financing needs. The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for off-balance sheet loan commitments is represented by the contractual amount of those instruments. Such financial instruments are recorded when they are funded.

The Company records an allowance for credit losses on off-balance sheet credit exposures, unless the commitments to extend credit are unconditionally cancelable, through a charge to provision for credit losses for unfunded commitments in the Company's consolidated statements of income. The allowance for credit losses on off-balance sheet credit exposures is estimated by loan segment at each balance sheet date under the CECL model using the same methodologies as portfolio loans, taking into consideration the likelihood that funding will occur as well as any third-party guarantees. The allowance for credit losses for unfunded commitments is included in "Accrued expenses and other liabilities" on the Company's consolidated balance sheets.

Land, Premises, and Equipment

Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Depreciation is charged to expense over the estimated useful lives of the assets, which range from 3 to 20 years for equipment and 18 to 40 years for buildings and improvements and is computed using the straight-line method for financial reporting purposes and a combination of straight-line and accelerated methods for tax purposes. The costs of major improvements are capitalized, while costs of ordinary maintenance and repairs are charged to expense as incurred.

Foreclosed Assets

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less selling costs at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, management periodically performs valuations, and the assets are carried at the lower of cost or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in "(Gains) on other real estate owned", in the Company's consolidated statements of income.

Stock Based Compensation

Compensation cost for grants of restricted shares is accounted for based on the closing price of the Company's common stock on the date the restricted shares are awarded. Compensation cost for restricted shares is recognized over the required service period, generally defined as the vesting period.

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 Company – put presumptively beyond reach of the transferor and its creditors, even in bankruptcy or other receivership, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets.

Intangible Assets

Acquired intangible assets (such as core deposit intangibles) are separately recognized if the benefit of the asset can be sold, transferred, licensed, rented, or exchanged, and are amortized over their useful life.

Bank-Owned Life Insurance

The Company has purchased life insurance policies on certain officers and directors. Bank-owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Leases

The Company's leases comprise primarily operating leases of real estate in which the Company or the Bank is the lessee. The Company recognizes a lease liability and a right-of-use asset in connection with leases in which it is a lessee, except for leases with a term of twelve (12) months or less. A lease liability represents the Company's obligation to make future payments under lease contracts, and a right-of-use asset represents the Company's right to control the use of the underlying property during the lease term. Lease liabilities and right-of-use assets are recognized upon commencement of a lease and measured as the present value of lease payments over the lease term, discounted at the incremental borrowing rate of the lessee. The Company has elected not to separate lease and nonlease components within the same contract and instead to account for the entire contract as a lease.

Income Taxes

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

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the consolidated financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more likely than not recognition threshold are measured as the largest amount of tax benefit that is more than fifty (50) percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying consolidated balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination.

At December 31, 2023, and 2022, the Company has not identified and recorded any uncertain tax positions. Interest and penalties associated with the unrecognized tax benefits, if any, are classified as additional income taxes in the consolidated statements of income.

Advertising Expense

The Company follows the policy of charging the costs of advertising to expense as incurred. Total advertising expense incurred for the years ended December 31, 2023, and 2022 was $431 thousand and $241 thousand, respectively.

Earnings and Dividends Per Common Share

Basic earnings per common share represents income available to common shareholders divided by the weighted average number of common shares outstanding during the period. Diluted earnings per common share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued. The Company had convertible preferred shares of 29,148 as of December 31, 2023, and 2022. Each of these preferred shares is convertible to common shares at the price of $2.00 per share. All preferred shares were considered dilutive at each respective year-end. As of December 31, 2023, there were 26,562 unvested restricted shares included in total common shares outstanding. As of December 31, 2022, there were 27,830 unvested restricted shares included in total common shares outstanding.

Comprehensive Income

U.S. GAAP generally requires that recognized revenue, expenses, gains, and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on AFS investment securities, are reported as a separate component of the shareholders' equity section of the consolidated balance sheet. Such items, along with net income, are components of comprehensive income. The only component of accumulated other comprehensive income for the Company relates to adjustments for net unrealized gains and losses on AFS investment securities.

Off-Balance Sheet Credit Related Financial Instruments

In the ordinary course of business, the Company has entered into commitments to extend credit, including commitments under line of credit arrangements, commercial letters of credit, and standby letters of credit. Such financial instruments are recorded when they are funded.

Fair Value of Financial Instruments

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully discussed in Note 17 to the consolidated financial statements. Fair value estimates involve uncertainties and matters of significant judgment. Changes in assumptions or in market conditions significantly affect the estimates.

Reclassification

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

Recent Accounting Pronouncements

In March 2020, the FASB issued ASU 2020-04, *Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting*. The amendments in this ASU provide temporary optional guidance to ease the potential burden in accounting for reference rate reform. The ASU provides optional expedients and exceptions for applying U.S. GAAP to contract modifications and hedging relationships, subject to meeting certain criteria, that reference the London Interbank Offered Rate ("LIBOR"), or another reference rate expected to be discontinued. It is intended to help stakeholders during the global market-wide reference rate transition period. ASU 2022-06, *Reference Rate Reform (Topic 848): Deferral of the Sunset Date of Topic 848* was issued in December 2022 to defer the sunset of Topic 848 from December 31, 2022, to December 31, 2024, after which entities will no longer be permitted to apply the relief in Topic 848. The Company does not currently have material exposure to instruments indexed to LIBOR and does not anticipate engaging in new transactions that use LIBOR as a reference rate.

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

Note 2. Investment Securities

Investment securities have been classified in the consolidated balance sheets according to management's intent. At December 31, 2023, and 2022, the Company had no investment securities classified as HTM. The amortized cost and fair value of AFS investment securities, with gross unrealized gains and losses at December 31 are as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
2023				
AFS				
U. S. Government agencies	$ 5,525	$ -	$ (258)	$ 5,267
Mortgage-backed securities	33,169	3	(5,088)	28,084
Taxable municipal securities	19,432	-	(3,759)	15,673
Tax-exempt municipal securities	16,122	6	(1,819)	14,309
Corporate securities	11,033	-	(1,196)	9,837
Total	$ 85,281	$ 9	$ (12,120)	$ 73,170
2022				
AFS				
U. S. Government agencies	$ 5,887	$ -	$ (362)	$ 5,525
Mortgage-backed securities	36,291	10	(5,566)	30,735
Taxable municipal securities	19,450	-	(4,450)	15,000
Tax-exempt municipal securities	16,024	5	(2,375)	13,654
Corporate securities	12,590	-	(1,154)	11,436
Total	$ 90,242	$ 15	$ (13,907)	$ 76,350

There was no allowance for credit losses on AFS investment securities as of December 31, 2023.

There were no investment securities transferred between the AFS and HTM portfolios during the periods presented. In the future management may elect to classify investment securities as HTM based upon such considerations as the nature of the investment security, the Company's ability to hold the investment security until maturity, and general economic conditions.

The contractual maturities of AFS investment securities at December 31, 2023, are shown below. Expected maturities may differ from contractual maturities because mortgages underlying the mortgage-backed securities may be called or prepaid without any penalties.

	AFS	
Investment securities *(in thousands)*	**Amortized Cost**	**Fair Value**
Maturing within one year	$ 22	$ 22
Maturing after one year, but within five years	3,800	3,697
Maturing after five years but within ten years	24,772	21,992
Maturing after ten years	56,687	47,459
Total	$ 85,281	$ 73,170

At December 31, 2022, the Company's corporate securities portfolio contained $1.0 million of an investment in subordinated notes issued by Signature Bank of New York ("SBNY"). As a result of and subsequent to the failure of SBNY during the first quarter of 2023, the Company determined its investment in SBNY subordinated notes was uncollectible. In connection with this determination, during the first quarter of 2023 the Company established an allowance for credit losses through a provision for credit losses in the amount of $1.0 million related to its investment in SBNY subordinated notes, which was fully charged off in the same period. During the fourth quarter of 2023, the Company sold its investment in SBNY subordinated notes for gross proceeds of approximately $206 thousand and recorded a (recovery of) credit losses for the same amount. During the year ended December 31, 2023, there were no other AFS investment securities that had an allowance for credit losses. There were no other sales of AFS investment securities during the year ended December 31, 2023. During the year ended December 31, 2022, sales of AFS investment securities totaled $6.1 million, with losses of $135 thousand being recognized on these sales. Gains and losses on the sale of AFS investment securities are recorded on the trade date and are determined using the specific identification method.

There were no AFS investment securities pledged to secure public deposits or for other purposes required by law at December 31, 2023, or 2022. The Company utilizes a Letter of Credit through the FHLB for meeting the collateral requirements of such deposits.

At December 31, 2023, the Company had pledged AFS investment securities with a fair value of approximately $21.5 million to the FRB to secure its borrowing capacity under the Discount Window and the Bank Term Funding Program ("BTFP"). At December 31, 2022, the Company had pledged AFS investment securities with a fair value of approximately $734 thousand to the FRB to secure its borrowing capacity under the Discount Window.

Restricted equity securities totaled $4.0 million at December 31, 2023, and $2.8 million at December 31, 2022. Restricted equity securities consist of investments in stock of the FRB, FHLB, and CBB, all of which are carried at cost. All of these entities are upstream correspondents of the Company. The FRB requires banks to purchase stock as a condition for membership in the Federal Reserve System. The FHLB requires financial institutions to make equity investments in the FHLB in order to borrow money. The Company's stock in CBB is restricted only in the fact that the stock may only be repurchased by the respective bank.

The following table details unrealized losses and related fair values in the Company's AFS investment securities portfolios for which an allowance for credit losses has not been recorded at December 31, 2023, and was not required at December 31, 2022. This information is aggregated by the length of time that individual AFS investment securities have been in a continuous unrealized loss position as of December 31, 2023 and 2022 (in thousands).

	Total		Less than 12 Months		12 Months or Greater	
	Fair Value	Unrealized (Loss)	Fair Value	Unrealized (Loss)	Fair Value	Unrealized (Loss)
2023						
Description						
U. S. Government agencies	$ 4,631	$ (258)	$ -	$ -	$ 4,631	$ (258)
Mortgage-backed securities	27,215	(5,088)	-	-	27,215	(5,088)
Taxable municipals	15,673	(3,759)	-	-	15,673	(3,759)
Tax-exempt municipals	13,821	(1,819)	-	-	13,821	(1,819)
Corporate securities	8,937	(1,196)	-	-	8,937	(1,196)
Unrealized Loss Positions	$ 70,277	$ (12,120)	$ -	$ -	$ 70,277	$ (12,120)
2022						
Description						
U. S. Government agencies	$ 5,525	$ (362)	$ 2,884	$ (116)	$ 2,641	$ (246)
Mortgage-backed securities	29,738	(5,566)	9,927	(1,000)	19,811	(4,566)
Taxable municipals	15,000	(4,450)	4,464	(764)	10,536	(3,686)
Tax-exempt municipals	13,415	(2,375)	9,005	(1,137)	4,410	(1,238)
Corporate securities	10,536	(1,154)	3,840	(155)	6,696	(999)
Unrealized Loss Positions	$ 74,214	$ (13,907)	$ 30,120	$ (3,172)	$ 44,094	$ (10,735)

At December 31, 2023, one hundred ten (110) AFS investment securities with unrealized losses had depreciated approximately 14.7% from their total amortized cost basis. Management evaluates all AFS investment securities in an unrealized loss position on a quarterly basis, and more frequently when economic or market conditions warrant such evaluation. If the Company has the intent to sell the investment security or it is more likely than not that the Company will be required to sell the investment security, the investment security is written down to fair value and the entire loss is recorded in earnings.

If either of the above criteria is not met, the Company evaluates whether the decline in fair value is the result of credit losses or other factors. In making the assessment, the Company may consider various factors including the extent to which fair value is less than amortized cost, performance on any underlying collateral, downgrades in the ratings of the investment security by a rating agency, the failure of the issuer to make scheduled interest or principal payments and adverse conditions specifically related to the investment security. If the assessment indicates that a credit loss exists, the present value of cash flows expected to be collected are compared to the amortized cost basis of the investment security and any excess is recorded as an allowance for credit losses, limited by the amount that the fair value is less than the amortized cost basis. Any amount of unrealized loss that has not been recorded through an allowance for credit losses is recognized in other comprehensive income.

Changes in the allowance for credit losses are recorded as provision for (or reversal of) credit loss expense. Losses are charged against the allowance for credit losses when management believes an AFS investment security is confirmed to be uncollectible or when either of the criteria regarding intent or requirement to sell is met.

Note 3. Loans

The composition of loans at December 31, 2023, and 2022 is as follows (in thousands):

	2023	2022
Real Estate:		
Construction & Development	$ 35,646	$ 38,323
1-4 Family	211,429	178,557
Commercial Real Estate, Owner Occupied	82,396	87,491
Commercial Real Estate, Non-Owner Occupied	133,053	129,351
Other	46,286	53,494
Total loans	508,810	487,216
Less: Allowance for credit losses	4,979	4,881
Loans, net of allowance for credit losses	$ 503,831	$ 482,335

Included in total loans above are deferred loan fees, net of deferred loan costs, of $490 thousand and $701 thousand at December 31, 2023, and 2022, respectively. Income from net deferred loan fees and costs is recognized over the lives of the respective loans as a yield adjustment. If loans repay prior to scheduled maturities any unamortized fee or cost is recognized at that time.

The Company elected to exclude accrued interest receivable from the amortized cost basis of loans. Accrued interest receivable related to loans totaled $1.3 million at December 31, 2023, and $1.2 million at December 31, 2022, and was reported in "Accrued interest receivable" on the consolidated balance sheets.

The accretable discount on the acquired performing loans was $0 and $95 thousand at December 31, 2023 and 2022, respectively.

Purchased Credit Deteriorated

There were no PCD loans acquired during the years ended December 31, 2023 and 2022, respectively.

During 2017, the Company acquired loans as a result of the CCB merger, for which there was, at acquisition, evidence of deterioration of credit quality since origination and it was probable, at acquisition, that all contractually required payments would not be collected. The carrying amount of those loans at December 31, 2023, and 2022 are as follows (in thousands):

December 31, 2023	PCD Loans
Construction & Development	$ -
1-4 Family	664
Commercial Real Estate, Owner Occupied	-
Commercial Real Estate, Non-Owner Occupied	-
Other	-
Total PCD loans	$ 664

December 31, 2022	**PCI Loans**
Construction & Development	$ -
1-4 Family	590
Commercial Real Estate, Owner Occupied	-
Commercial Real Estate, Non-Owner Occupied	-
Other	-
Total PCI loans	$ 590

Changes in the accretable yield for PCD and PCI loans were as follows for the years ended December 31, 2023 and 2022 (in thousands):

	2023	**2022**
Accretable yield, beginning of year balance	$ 76	$ 138
Accretion	(155)	(143)
Reclassification from nonaccretable difference	79	34
Other changes, net	-	47
Accretable yield, end of year balance	$ -	$ 76

Aging Analysis

The following tables present an aging analysis of past due loans by category as of December 31, 2023 and 2022 (in thousands):

	30-59 Days Past Due	**60-89 Days Past Due**	**90+ Days Past Due and Still Accruing**	**Nonaccrual Loans**	**Current**	**Total Loans**
December 31, 2023						
Construction & Development	$ -	$ -	$ 100	$ -	$ 35,546	$ 35,646
1-4 Family	122	65	-	301	210,941	211,429
Commercial Real Estate, Owner Occupied	6	-	-	-	82,390	82,396
Commercial Real Estate, Non-Owner Occupied	-	-	-	-	133,053	133,053
Other	-	2	-	25	46,259	46,286
Total	$ 128	$ 67	$ 100	$ 326	$ 508,189	$ 508,810
December 31, 2022						
Construction & Development	$ -	$ -	$ -	$ -	$ 38,323	$ 38,323
1-4 Family	109	107	-	416	177,925	178,557
Commercial Real Estate, Owner Occupied	8	-	-	-	87,483	87,491
Commercial Real Estate, Non-Owner Occupied	-	-	-	-	129,351	129,351
Other	41	15	31	-	53,407	53,494
Total	$ 158	$ 122	$ 31	$ 416	$ 486,489	$ 487,216

Credit Quality Indicators

Management closely monitors the quality of the loan portfolio and has established a loan review process designed to help grade the quality of the Company's loan portfolio. The Company's loan ratings coincide with the "Substandard," "Doubtful" and "Loss" classifications used by federal regulators in their examination of financial institutions. Generally, an asset is considered "Substandard" if it is inadequately protected by the current net worth and paying capacity of the obligors and/or the collateral pledged. "Substandard" assets include those characterized by the distinct possibility that the insured financial institution will sustain some loss if the deficiencies are not corrected. Assets classified as "Doubtful" have all the weaknesses inherent in assets classified "Substandard" with the added characteristic that the weaknesses present make collection or liquidation in full, on the basis of currently existing facts, highly questionable and improbable. Assets classified as "Loss" are those considered uncollectible, and of such little value that its continuance on the books is not warranted. As of December 31, 2023, the Company had no loans graded "Loss" included in the balance of total loans outstanding. As of December 31, 2022, the Company had no loans graded "Doubtful" or "Loss" included in the balance of total loans outstanding.

Assets that do not currently expose the insured financial institutions to sufficient risk to warrant classification in one of the aforementioned categories but otherwise possess weaknesses are designated "Special Mention." Management also maintains a listing of loans designated "Watch". These loans represent borrowers with declining earnings, strained cash flow, increasing leverage and/or weakening market fundamentals that indicate above average risk. Loans that are currently performing and are of high quality are given a loan rating of "Pass".

Loans are graded at origination and will be considered for potential downgrades as the borrower experiences financial difficulties. Loan officers meet periodically to discuss their past due credits and loan downgrades could occur at that time. Commercial loans of over $1.0 million are reviewed on an annual basis, and that review could result in downgrades or in some cases, upgrades. In addition, the Company engages an independent, third-party loan review on an annual basis. The results of these loan reviews could result in upgrades or downgrades.

The following table presents the Company's recorded investment in loans by credit quality indicators by year of origination as of December 31, 2023 (in thousands):

	Term Loans by Year of Origination							
	2023	2022	2021	2020	2019	Prior	Revolving	Total
Construction & Development								
Pass	$ 15,387	$ 10,333	$ 3,104	$ 720	$ 573	$ 1,167	$ 1,027	$ 32,311
Watch	28	3,265	-	-	-	42	-	3,335
Special Mention	-	-	-	-	-	-	-	-
Substandard	-	-	-	-	-	-	-	-
Total Construction & Development	$ 15,415	$ 13,598	$ 3,104	$ 720	$ 573	$ 1,209	$ 1,027	$ 35,646
Current period gross write-offs	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
1-4 Family								
Pass	$ 29,402	$ 56,277	$ 51,657	$ 17,149	$ 7,917	$ 26,728	$ 15,133	$ 204,263
Watch	132	2,525	562	393	86	2,637	61	6,396
Special Mention	-	-	-	-	282	92	-	374
Substandard	-	-	-	-	-	396	-	396
Total 1-4 Family	$ 29,534	$ 58,802	$ 52,219	$ 17,542	$ 8,285	$ 29,853	$ 15,194	$ 211,429

Current period gross write-offs	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Commercial Real Estate, Owner Occupied								
Pass	$ 6,932	$ 14,814	$ 13,105	$ 12,615	$ 2,724	$ 19,725	$ 1,691	$ 71,606
Watch	-	1,089	3,199	221	390	2,076	-	6,975
Special Mention	-	-	-	-	1,696	2,039	-	3,735
Substandard	-	-	-	-	-	80	-	80
Total Commercial Real Estate, Owner Occupied	$ 6,932	$ 15,903	$ 16,304	$ 12,836	$ 4,810	$ 23,920	$ 1,691	$ 82,396
Current period gross write-offs	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Commercial Real Estate, Non-Owner Occupied								
Pass	$ 27,716	$ 34,937	$ 19,345	$ 2,170	$ 5,206	$ 22,303	$ 2,089	$ 113,766
Watch	6,101	5,212	-	4,515	-	3,125	-	18,953
Special Mention	-	-	-	-	-	-	-	-
Substandard	-	-	-	-	-	334	-	334
Total Commercial Real Estate, Non-Owner Occupied	$ 33,817	$ 40,149	$ 19,345	$ 6,685	$ 5,206	$ 25,762	$ 2,089	$ 133,053
Current period gross write-offs	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Other								
Pass	$ 9,549	$ 7,865	$ 4,098	$ 2,295	$ 5,022	$ 3,953	$ 6,235	$ 39,017
Watch	138	2,316	3,483	161	91	533	391	7,113
Special Mention	-	-	-	-	-	-	-	-
Substandard	-	-	-	-	-	130	1	131
Doubtful	-	25	-	-	-	-	-	25
Total Other	$ 9,687	$ 10,206	$ 7,581	$ 2,456	$ 5,113	$ 4,616	$ 6,627	$ 46,286
Current period gross write-offs	$ -	$ 174	$ 12	$ -	$ -	$ -	$ -	$ 186
Total loans								
Pass	$ 88,986	$ 124,226	$ 91,309	$ 34,949	$ 21,442	$ 73,876	$ 26,175	$ 460,963
Watch	6,399	14,407	7,244	5,290	567	8,413	452	42,772
Special Mention	-	-	-	-	1,978	2,131	-	4,109
Substandard	-	-	-	-	-	940	1	941
Doubtful	-	25	-	-	-	-	-	25
Total loans	$ 95,385	$ 138,658	$ 98,553	$ 40,239	$ 23,987	$ 85,360	$ 26,628	$ 508,810
Total current period gross write-offs	$ -	$ 174	$ 12	$ -	$ -	$ -	$ -	$ 186

The following table presents the Company's recorded investment in loans by credit quality indicators as of December 31, 2022 (in thousands):

	Construction & Development	1-4 Family	Commercial Real Estate Owner Occupied	Commercial Real Estate Non-Owner Occupied	Other	Total
December 31, 2022						
Pass	$ 38,071	$ 164,545	$ 74,179	$ 111,542	$ 45,337	$ 433,674
Watch	44	12,588	11,308	13,793	8,022	45,755
Special Mention	-	323	1,912	3,532	-	5,767
Substandard	208	1,101	92	484	135	2,020
Total	$ 38,323	$ 178,557	$ 87,491	$ 129,351	$ 53,494	$ 487,216

Nonaccrual Loans

The following table is a summary of the Company's nonaccrual loans by major categories for the periods indicated (in thousands):

	CECL			Incurred Loss
	December 31, 2023			December 31, 2022
	Nonaccrual Loans with no Allowance	Nonaccrual Loans with an Allowance	Total Nonaccrual Loans	Nonaccrual Loans
Construction & Development	$ -	$ -	$ -	$ -
1-4 Family	201	100	301	416
Commercial Real Estate, Owner Occupied	-	-	-	-
Commercial Real Estate, Non-Owner Occupied	-	-	-	-
Other	-	25	25	-
Total	$ 201	$ 125	$ 326	$ 416

The Company recognized approximately $20 thousand of interest income on nonaccrual loans during the year ended December 31, 2023.

The following table represents the accrued interest receivables written off on nonaccrual loans by reversing interest income during the year ended December 31, 2023 (in thousands):

	For the Year Ended December 31, 2023
Construction & Development	$ -
1-4 Family	4
Commercial Real Estate, Owner Occupied	-
Commercial Real Estate, Non-Owner Occupied	-
Other	-
Total loans	$ 4

Collateral Dependent Loans

Loans that do not share risk characteristics within their respective loan pools are individually evaluated. The Company has certain loans for which repayment is dependent upon the operation or sale of collateral, as the borrower is experiencing financial difficulty. The underlying collateral can vary based upon the type of loan. The following provides more detail about the types of collateral that secure collateral dependent loans:

- Construction and development loans include both commercial and consumer loans. Commercial loans are typically secured by first liens on raw land acquired for the construction of owner occupied commercial real estate or non-owner occupied commercial real estate. Consumer loans are typically secured by a first lien on raw land acquired for the construction of residential homes for which a binding sales contract exists.
- Commercial real estate loans can be secured by either owner occupied commercial real estate or non-owner occupied investment commercial real estate. Typically, owner occupied commercial real estate loans are secured by office buildings, warehouses, manufacturing facilities and other commercial and industrial properties occupied by operating companies. Non-owner occupied commercial real estate loans are generally secured by office buildings and complexes, retail facilities, multifamily complexes, land under development, industrial properties, as well as other commercial or industrial real estate.
- Residential real estate loans are typically secured by first mortgages, and in some cases could be secured by a second mortgage.
- Home equity lines of credit are generally secured by second mortgages on residential real estate property.
- Consumer loans are generally secured by automobiles, motorcycles, recreational vehicles, and other personal property. Some consumer loans are unsecured and have no underlying collateral.

The following table details the amortized cost of collateral dependent loans as of December 31, 2023 (in thousands):

	For the Year Ended December 31, 2023
Construction & Development	$ -
1-4 Family	201
Commercial Real Estate, Owner Occupied	-
Commercial Real Estate, Non-Owner Occupied	-
Other	130
Total loans	$ 331

Note 4. Allowance for Credit Losses

Allowance for Credit Losses – Loans

The following table summarizes the activity related to the allowance for credit losses for the year ended December 31, 2023 under the CECL methodology (in thousands):

	Construction & Development	1-4 Family	Commercial Real Estate Owner Occupied	Commercial Real Estate Non-Owner Occupied	Other	Total
Balance, December 31, 2022	$ 355	$ 1,721	$ 850	$ 1,229	$ 726	$ 4,881
Charge-offs	-	-	-	-	(186)	(186)
Recoveries	-	13	-	-	96	109
Provision for (recovery of) credit losses	(21)	264	(61)	77	(84)	175
Balance, December 31, 2023	$ 334	$ 1,998	$ 789	$ 1,306	$ 552	$ 4,979

The transition adjustment for the adoption of ASC 326 on January 1, 2023 resulted in no change in the allowance for credit losses on loans.

Prior to the adoption of ASC 326 on January 1, 2023, the Company calculated the allowance for loan losses under the Incurred Loss methodology. The following tables are disclosures related to the allowance for loan losses in prior periods.

The following table summarizes the activity related to the allowance for loan losses for the year ended December 31, 2022 under the Incurred Loss methodology (in thousands):

	Construction & Development	1-4 Family	Commercial Real Estate Owner Occupied	Commercial Real Estate Non-Owner Occupied	Other	Total
Allowance for loan losses:						
Balance, January 1, 2022	$ 296	$ 1,390	$ 1,024	$ 1,067	$ 598	$ 4,375
Charge-offs	-	(28)	-	-	(152)	(180)
Recoveries	-	7	-	-	74	81
Provision (recovery)	59	352	(174)	162	206	605
Balance, December 31, 2022	$ 355	$ 1,721	$ 850	$ 1,229	$ 726	$ 4,881

Impaired Loans

Prior to the adoption of ASC 326, a loan was considered impaired when it is probable that the Company will be unable to collect all contractual principal and interest payments due in accordance with the original or modified terms of the loan agreement. Smaller balance homogenous loans may be collectively evaluated for impairment. Non-homogenous impaired loans are either measured based on the estimated fair value of the collateral less estimated cost to sell if the loan is considered collateral dependent or measured based on the present value of expected future cash flows if not collateral dependent. The valuation of real estate collateral is subjective in nature and may be adjusted in future periods because of changes in economic conditions. Management considers third-party appraisals, as well as independent fair market value assessments in determining the estimated fair value of particular properties. In addition, as certain of these third-party appraisals and independent fair market value assessments are only updated periodically, changes in the values of specific properties may have occurred subsequent to the most recent appraisals. Accordingly, the amounts of any such potential changes and any related adjustments are generally recorded at the time such information is received. When the measurement of the impaired loan is less than the recorded investment in the loan, impairment is recognized by creating or adjusting an allocation of the allowance for loan losses and uncollected accrued interest is reversed against interest income. If ultimate collection of principal is in doubt, all cash receipts on impaired loans are applied to reduce the principal balance.

The following table presents information on the loans evaluated for impairment in the allowance for loan losses as of December 31, 2022 (in thousands):

	Construction & Development	1-4 Family	Commercial Real Estate Owner Occupied	Commercial Real Estate Non-Owner Occupied	Other	Total
Individually evaluated for impairment	$ -	$ 20	$ -	$ -	$ -	$ 20
Collectively evaluated for impairment	355	1,701	850	1,229	726	4,861
Acquired loans PCI	-	-	-	-	-	-
Principal loan balances as of December 31, 2022	$ 38,323	$ 178,557	$ 87,491	$ 129,351	$ 53,494	$ 487,216
Individually evaluated for impairment	-	911	92	484	135	1,622
Collectively evaluated for impairment	38,323	177,646	87,399	128,867	53,359	485,594
Acquired loans PCI	-	590	-	-	-	590

The following table presents loans individually evaluated for impairment by class of loans, excluding PCI loans, as of December 31, 2022 (in thousands):

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance for loan losses:					
1-4 Family	$ 830	$ 832	$ -	$ 878	$ 53
Commercial Real Estate, Owner Occupied	92	92	-	100	6
Commercial Real Estate, Non-Owner Occupied	484	484	-	504	33
Other	135	135	-	138	8
With an allowance for loan losses recorded:					
1-4 Family	81	87	20	92	7
Total:					
1-4 Family	$ 911	$ 919	$ 20	$ 970	$ 60
Commercial Real Estate, Owner Occupied	92	92	-	100	6
Commercial Real Estate, Non-Owner Occupied	484	484	-	504	33
Other	135	135	-	138	8
	$ 1,622	$ 1,630	$ 20	$ 1,711	$ 107

Modifications Made to Borrowers Experiencing Financial Difficulty

The allowance for credit losses incorporates an estimate of lifetime expected credit losses and is recorded on each asset upon asset origination or acquisition. The starting point for the estimate of the allowance for credit losses is historical loss information, which includes losses from modifications of receivables to borrowers experiencing financial difficulty. The Company uses a probability of default/loss given default model to determine the allowance for credit losses. An assessment of whether a borrower is experiencing financial difficulty is made on the date of a modification. There are no commitments to lend additional funds to borrowers experiencing financial difficulty.

Because the effect of most modifications made to borrowers experiencing financial difficulty is already included in the allowance for credit losses because of the measurement methodologies used to estimate the allowance, a change to the allowance for credit losses is generally not recorded upon modification. Occasionally, the Company modifies loans by providing principal forgiveness on certain of its real estate loans. When principal forgiveness is provided, the amortized cost basis of the asset is written off against the allowance for credit losses. The amount of the principal forgiveness is deemed to be uncollectible; therefore, that portion of the loan is written off, resulting in a reduction of the amortized cost basis and a corresponding adjustment to the allowance for credit losses.

In some cases, the Company will modify a certain loan by providing multiple types of concessions. Typically, one type of concession, such as a term extension, is granted initially. If the borrower continues to experience financial difficulty, another concession, such as principal forgiveness or an interest rate reduction, may be granted.

As of December 31, 2023, the Company did not have any loans made to borrowers experiencing financial difficulty that were modified during the year ended December 31, 2023, and as such, did not have any loans made to borrowers experiencing financial difficulty that subsequently defaulted. Payment default is defined as movement to nonperforming status, foreclosure or charge-off, whichever occurs first.

Upon the Company's determination that a modified loan (or portion of a loan) has subsequently been deemed uncollectible, the loan (or a portion of the loan) is written off. Therefore, the amortized cost basis of the loan is reduced by the uncollectible amount and the allowance for credit losses is adjusted by the same amount.

Troubled Debt Restructurings

Prior to the adoption of ASC 326 on January 1, 2023, the Company utilized the Incurred Loss methodology that required the Company to account for certain loan modifications or restructurings as TDRs. A TDR is a loan for which the Company, for reasons related to the borrower’s financial difficulties, grants a concession to the borrower that the Company would not otherwise consider. The loan terms which have been modified or restructured due to a borrower’s financial difficulty, include but are not limited to: a reduction in the stated interest rate; an extension of the maturity at an interest rate below current market; a reduction in the face amount of the debt; a reduction in the accrued interest; or re-aging, extensions, deferrals, and renewals.

TDRs totaled $308 thousand at December 31, 2022. There was no new TDRs during the year ended December 31, 2022. The Company had no loans classified as TDRs that defaulted during the year ended December 31, 2022 that were originally modified during the twelve (12) months preceding the default. There was one TDR totaling $244 thousand excluded from impaired loan disclosures as of December 31, 2022.

Unfunded Commitments

The Company maintains a separate reserve for credit losses on off-balance-sheet credit exposures, including unfunded loan commitments, which is included in “Accrued expenses and other liabilities” on the consolidated balance sheets. The reserve for credit losses on off-balance-sheet credit exposures is adjusted as a provision for (recovery of) credit losses in the consolidated statements of income. The estimate includes consideration of the likelihood that funding will occur and an estimate of expected credit losses on commitments expected to be funded over its estimated life, utilizing the same models and approaches for the Company's other loan portfolio segments described above, as these unfunded commitments share similar risk characteristics as its loan portfolio segments. The Company has identified the unfunded portion of certain lines of credit as unconditionally cancellable credit exposures, meaning the Company can cancel the unfunded commitment at any time. No credit loss estimate is reported for off-balance-sheet credit exposures that are unconditionally cancellable by the Company or for undrawn amounts under such arrangements that may be drawn prior to the cancellation of the arrangement.

The following table presents the balance and activity in the allowance for credit losses for unfunded loan commitments for the year ended December 31, 2023 (in thousands):

	Total Allowance for Credit Losses-Unfunded Commitments
Balance, December 31, 2022	$ -
Adjustment to allowance for unfunded commitments for adoption of ASU 2016-13	25
Provision for credit losses - unfunded commitments	-
Balance, December 31, 2023	$ 25

Note 5. Land, Premises and Equipment, Net

Land, premises and equipment, net at December 31 are composed of the following (in thousands):

	2023	**2022**
Land	$ 2,439	$ 2,436
Company building and improvements	13,354	13,185
Furniture and equipment	6,558	6,393
Automobiles	134	136
Total land, premises and equipment	22,485	22,150
Less accumulated depreciation	(11,176)	(10,331)
Net land, premises and equipment	$ 11,309	$ 11,819

Depreciation expense for the years ended December 31, 2023 and 2022 amounted to $878 thousand and $921 thousand, respectively.

Note 6. Deposits

The aggregate amounts of time deposits in denominations of $250 thousand or more at December 31, 2023 and 2022 are $30.7 million and $16.2 million, respectively. At December 31, 2023, the scheduled maturities of time deposits are as follows (in thousands):

2024	$ 112,429
2025	21,826
2026	6,338
2027	2,423
2028	1,620
2029	24
Total	$ 144,660

The aggregate amounts of deposit overdrafts reclassified as loans at December 31, 2023 and 2022 are $173 thousand and $192 thousand, respectively. The Company is a member of the "Certificate of Deposit Account Registry Services" ("CDARS") network. At December 31, 2023, and 2022, the Company did not hold any funds in CDARS certificates.

Note 7. Borrowings

At December 31, 2023, and 2022, the Company had $49.0 million and $31.0 million of outstanding FHLB advances, respectively. As of December 31, 2023, outstanding FHLB advances consisted of the following (in thousands):

	Aggregate Principal	Fixed Borrowing Rate
Advance maturing on July 17, 2024	$ 10,000	4.82%
Advance maturing on January 17, 2025	10,000	4.52%
Advance maturing on June 23, 2025	5,000	4.96%
Advance maturing on September 19, 2025	2,000	4.00%
Advance maturing on January 16, 2026	5,000	4.05%
Advance maturing on June 23, 2026	5,000	4.48%
Advance maturing on June 23, 2027	5,000	4.35%
Advance maturing on September 17, 2027	2,000	3.84%
Advance maturing on June 23, 2028	5,000	4.17%
Total	$ 49,000	

At December 31, 2023, the Company had $43.0 million available under unsecured open lines of credit with other financial institutions, $107.3 million available under a secured line of credit with the FHLB, $625 thousand available under a secured line of credit (Discount Window) with the FRB, $23.7 million available under a secured line of credit (BTFP) with the FRB, and $5.0 million available under a secured, revolving line of credit with CBB. At December 31, 2023, the Company had loans with a carrying value of $292.5 million pledged as collateral to the FHLB, AFS investment securities with a carrying value of $21.5 million pledged as collateral to the FRB, and all the Bank's common shares outstanding pledged as collateral to CBB.

At December 31, 2023, the Company had two outstanding issuances of subordinated debt, the carrying value of which is $17.7 million, net of issuance costs. On August 12, 2020, the Company issued $8.0 million of 6.00% fixed-to-floating rate subordinated notes due August 15, 2030. These notes bear an interest rate of 6.00% and are callable after August 15, 2025. Beginning on August 15, 2025, any notes still outstanding will bear a variable interest rate equal to the three-month Secured Overnight Financing Rate ("SOFR") plus 596 basis points. On January 19, 2022, the Company issued $10.0 million of 4.00% fixed-to-floating rate subordinated notes due January 30, 2032. These notes bear an interest rate of 4.00% and are callable after January 30, 2027. Beginning on January 30, 2027, any notes still outstanding will bear a variable interest rate equal to the three-month SOFR plus 263 basis points.

Interest on the subordinated notes is paid semi-annually, in arrears, on a 360-day basis. The notes may not generally be redeemed prior to the fifth anniversary. After that time, they can be redeemed by the Company in whole at any time, or in part, upon any interest payment due date.

Note 8. Income Taxes

The Company files income tax returns in the U.S. federal jurisdiction. With few exceptions, the Company is no longer subject to U.S. federal tax examinations by tax authorities for years prior to 2020.

Income tax expense for the years ended December 31 consist of the following (in thousands):

	2023	2022
Current tax expense	$ 293	$ 732
Deferred tax benefit	(55)	(223)
Total	$ 238	$ 509

Income tax expense is computed by applying the U.S. Federal income tax rate of 21% to earnings before income taxes as a result of the following (in thousands):

	2023	2022
Computed "expected" tax expense	$ 388	$ 957
Tax-exempt interest, net	(78)	(99)
Bank-owned life insurance	(79)	(150)
Other, net	7	(199)
Total	$ 238	$ 509

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31 are presented below (in thousands):

	2023	2022
Deferred Tax Assets		
Net unrealized loss on investment securities AFS	$ 2,543	$ 2,917
Allowance for credit losses	1,046	953
Deferred compensation plans	145	170
Nonaccrual	1	2
Other	618	728
Deferred tax assets	4,353	4,770
Deferred Tax Liabilities		
Depreciation	215	223
Other	433	523
Deferred tax liabilities	648	746
Net deferred tax assets	$ 3,705	$ 4,024

Note 9. Employee Benefit Plan and Life Insurance

The Company has a 401(k) defined contribution plan available to substantially all employees. Employees may enter the plan on the first day of the month following their first thirty (30) days of employment.

Under this plan, the Company is required to match participating employees' contributions up to specified limits. The Company may, at its discretion, make additional contributions to the plan out of net profits in an amount determined by the Board of Directors. During the years ended December 31, 2023 and 2022, 401(k) plan contributions totaled $347 thousand and $475 thousand, respectively.

The Company is owner and beneficiary of life insurance policies on certain directors, retired directors, and certain current and former employees. The policy cash values totaled $12.4 million and $12.0 million at December 31, 2023 and 2022, respectively.

Note 10. Executive Supplemental Income Plans

The Company has entered into several supplemental income plans with current and former key executives. These plans are in the form of Deferred Compensation Agreements, a Salary Continuation Agreement and Supplemental Executive Retirement Plans. Benefits are to be paid for specific terms and amounts upon reaching age sixty-five (65) or retirement from the Company. All employees covered under the plans are vested in their benefits. Total liabilities for the various plans amounted to $692 thousand and $808 thousand as of December 31, 2023 and 2022, respectively.

Plan expense, based on the present value of the retirement benefits, amounted to $57 thousand and $48 thousand for the years ended December 31, 2023 and 2022, respectively. The plans are unfunded, however, life insurance has been acquired on these employees in amounts sufficient to discharge the obligations of the agreements.

Note 11. Related Party Transactions

The Company has had, and may be expected to have in the future, banking transactions in the ordinary course of business with directors, principal officers, and affiliated companies in which they are principal shareholders (commonly referred to as related parties) on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others. These persons and firms were indebted to the Company for loans totaling $4.1 million and $3.8 million at December 31, 2023 and 2022, respectively. Below is a summary of these transactions for the years ended December 31, 2023 and 2022 (in thousands).

	2023	2022
Balance at the beginning of the year	$ 3,758	$ 3,333
Additional borrowings	2,877	1,198
Curtailments	(2,498)	(773)
Balance at the end of the year	$ 4,137	$ 3,758

Deposits for related parties totaled $11.6 million and $14.5 million as of December 31, 2023 and 2022, respectively.

Note 12. Dividend Restrictions

As an entity incorporated under the laws of the Commonwealth of Virginia, legal restrictions are placed on allowable dividends. Further restrictions regarding capital adequacy are mandated by state and federal banking regulators. The Board of Directors maintains processes to ensure any declared dividends are prudent from a business perspective and in compliance with regulatory and legal requirements.

Note 13. Capital Requirements

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for Prompt Corrective Action ("PCA"), the Bank must meet specific capital guidelines (set forth in the table below) that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts, and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Management believes, as of December 31, 2023, and 2022, the Bank meets all capital adequacy requirements to which it is subject.

On September 17, 2019, the Federal Deposit Insurance Corporation ("FDIC") finalized a rule that introduced an optional simplified measure of capital adequacy for qualifying community banking organizations (i.e., the community bank leverage ratio ("CBLR") framework) as required by the Economic Growth, Regulatory Relief and Consumer Protection Act. The CBLR framework is designed to reduce burden by removing the requirements for calculating and reporting risk-based capital ratios for qualifying community banking organizations that opt into the framework. In order to qualify for the CBLR framework, a community banking organization must have a tier 1 leverage ratio of at least 9%, less than $10 billion in total consolidated assets, and limited amounts of off-balance-sheet exposures and trading assets and liabilities. A qualifying community banking organization that opts into the CBLR framework and meets all requirements under the framework will be considered to have met the well-capitalized ratio requirements under PCA regulations and is not required to report or calculate risk-based capital. The Bank adopted the CBLR framework beginning with its March 31, 2020 Call Report.

In April 2020, the federal banking agencies issued an interim final rule that makes temporary changes to the CBLR framework, pursuant to section 4012 of the Coronavirus Aid, Relief, and Economic Security ("CARES") Act, and a second interim final rule that provides a graduated increase in the CBLR requirement after the expiration of the temporary changes implemented pursuant to section 4012 of the CARES Act. Under the interim final rules, the CBLR minimum requirement is 8.5% as of December 31, 2021, and 9% for the calendar year and beyond. The interim rule allows for a two-quarter grace period to correct a CBLR that falls below the required amount, provided that the qualifying community banking organization maintains a CBLR greater than 7.5% as of December 31, 2021, and greater than 8% thereafter. Under the final rule, an eligible community banking organization can opt out of the CBLR framework and revert to the risk-weighting framework without restriction.

As of December 31, 2023, the most recent notification from the FRB categorized the Bank as well capitalized under the regulatory framework for PCA. To be categorized as well capitalized, the Bank must maintain a minimum CBLR as set forth in the table below. There are no conditions or events since that notification that management believes have changed the Bank's category.

	Actual		Minimum To Be Well Capitalized Under PCA Regulations (CBLR Framework)	
	Amount	**Ratio**	**Amount**	**Ratio**
(Dollars in Thousands)				
As of December 31, 2023:				
Community Bank Leverage Ratio (to Average Assets)	$ 65,478	9.68%	$ 60,880	9.0%
As of December 31, 2022:				
Community Bank Leverage Ratio (to Average Assets)	$ 61,737	10.13%	$ 54,834	9.0%

Note 14. Commitments and Contingencies

In the normal course of business, there are various outstanding commitments and contingent liabilities which are not reflected in the Company's consolidated financial statements. The Company does not anticipate any material losses because of these transactions. See Note 15 to the consolidated financial statements with respect to financial instruments with off-balance-sheet risk.

Note 15. Financial Instruments with Off-Balance-Sheet Risk

The Company is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk more than the amount recognized in the consolidated balance sheets. The contractual amounts of those instruments reflect the extent of involvement the Company has classes of financial instruments.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

A summary of the contractual amount of the Company's exposure to off-balance-sheet risk as of December 31 is as follows (in thousands):

	2023	2022
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit	$ 86,131	$ 97,407
Standby letters of credit	$ 1,179	$ 1,778

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 Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property and equipment, and income-producing commercial properties.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements, including commercial paper, bond financing, and similar transactions. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

Note 16. Concentrations of Credit Risk

Cash and cash equivalents on deposit with financial institutions more than amounts insured by the FDIC were $12.2 million and $4.3 million at December 31, 2023 and 2022, respectively. Management regularly monitors the financial stability of these financial institutions.

Substantially all of the Company's loans, commitments to extend credit, and standby letters of credit have been granted to customers in the Company's market area and such customers are generally depositors of the Company. Investments in state and municipal investment securities involve governmental entities within and outside the Company's market area. The concentrations of credit by type of loan are set forth in Note 3 to the consolidated financial statements. The distribution of commitments to extend credit approximates the distribution of loans outstanding. Standby letters of credit are granted primarily to commercial borrowers. The Company's primary focus is toward small business and consumer transactions, and accordingly, it does not have a significant number of credits to any single borrower or group of related borrowers.

Note 17. Fair Value Measurements

FASB ASC 825, *"Financial Instruments"*, requires disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet. The fair value of a financial instrument is the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. 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 financial instruments. FASB ASC 825 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Therefore, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company.

Fair Value Hierarchy: Under FASB ASC 820, *"Fair Value Measurements and Disclosures"*, the Company groups its financial assets and financial liabilities generally measured at fair value in three levels, based on the markets in which the financial assets and financial liabilities are traded and the reliability of the assumptions that are used to determine fair value. These levels are:

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

Level 2 - Valuation is based upon quoted prices for similar financial instruments in active markets, quoted prices for identical or similar financial 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 financial asset or financial liability. Valuation techniques may include the use of option pricing models, discounted cash flow models and similar techniques.

The following table presents the carrying or notional amounts, estimated fair values, and placement in the fair value hierarchy of the Company's financial instruments at December 31 (in thousands):

	Carrying Amount	Quoted Prices in Active Markets For Identical Assets or Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value Balances
December 31, 2023					
Financial assets:					
Cash and federal funds sold	$ 41,207	$ 41,207	$ -	$ -	$ 41,207
Interest-bearing time deposits in Banks	1,109	1,109	-	-	1,109
Securities AFS	73,170	-	73,170	-	73,170
Restricted equity securities	4,037	-	4,037	-	4,037
Loans, net	503,831	-	-	475,885	475,885
Bank-owned life insurance	12,406	-	12,406	-	12,406
Accrued interest receivable	1,928	-	1,928	-	1,928
Financial liabilities:					
Deposits	$ 542,239	$ -	$ -	$ 541,746	$ 541,746
FHLB advances	49,000	-	49,015	-	49,015
Subordinated debt, net	17,731	-	16,457	-	16,457
Accrued interest payable	1,181	-	1,181	-	1,181
December 31, 2022					
Financial assets:					
Cash and federal funds sold	$ 23,601	$ 23,601	$ -	$ -	$ 23,601
Interest-bearing time deposits in Banks	1,354	1,354	-	-	1,354
Securities AFS	76,350	-	76,350	-	76,350
Restricted equity securities	2,754	-	2,754	-	2,754
Loans, net	482,335	-	-	457,202	457,202
Bank-owned life insurance	12,046	-	12,046	-	12,046
Accrued interest receivable	1,729	-	1,729	-	1,729
Financial liabilities:					
Deposits	$ 526,553	$ -	$ -	$ 526,919	$ 526,919
FHLB advances	31,000	-	31,054	-	31,054
Subordinated debt, net	17,621	-	16,457	-	16,457
Accrued interest payable	493	-	493	-	493

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

Securities AFS: Securities AFS are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, when available (Level 1). If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar investment securities for which significant assumptions are derived primarily from or corroborated by observable market data. Third party vendors compile prices from various sources and may determine the fair value of identical or similar investment securities by using pricing models that consider observable market data (Level 2). If an investment security is measured using unobservable inputs (Level 3), it will, in most cases, incorporate a significant liquidity discount that is applied to directly observable inputs because of restrictions on redemptions such as lock-up periods, redemption rates, etc.

No financial liabilities were measured at fair value on a recurring basis as of December 31, 2023 or 2022. There were no significant transfers between levels during the years ended December 31, 2023 or 2022. The following table presents the balances of financial assets measured at fair value on a recurring basis as of December 31 (in thousands):

	Fair Value Measures at December 31 using			
	Balance as of December 31,	Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
2023				
Securities AFS:				
U.S. Government agencies	$ 5,267	$ -	$ 5,267	$ -
Mortgage-backed securities	28,084	-	28,084	-
Taxable municipal securities	15,673	-	15,673	-
Tax-exempt municipal securities	14,309	-	14,309	-
Corporate securities	9,837	-	9,837	-
Total Securities AFS at fair value	$ 73,170	$ -	$ 73,170	$ -
2022				
Securities AFS:				
U.S. Government agencies	$ 5,525	$ -	$ 5,525	$ -
Mortgage-backed securities	30,735	-	30,735	-
Taxable municipal securities	15,000	-	15,000	-
Tax-exempt municipal securities	13,654	-	13,654	-
Corporate securities	11,436	-	11,436	-
Total Securities AFS at fair value	$ 76,350	$ -	$ 76,350	$ -

Certain financial assets are measured at fair value on a nonrecurring basis in accordance with U.S. GAAP. Adjustments to the fair value of these financial assets usually result from the application of lower of cost or market accounting or write-downs of individual assets. No financial liabilities were measured at fair value on a nonrecurring basis as of December 31, 2023, and 2022.

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

Individually Evaluated Loans: Individually evaluated 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 agreement are evaluated for potential specific reserves and adjusted, if a shortfall exists, to fair value less costs to sell. Fair value is measured based on the value of the underlying collateral securing the loan if repayment is expected solely from the sale or operation of the collateral or present value of estimated future cash flows discounted at the loan's contractual interest rate if the loan is not determined to be collateral dependent. All loans individually evaluated are classified as Level 3 in the fair value hierarchy.

Fair value for individually evaluated loans is determined using several methods. Generally, the fair value of real estate is determined based on appraisals by qualified licensed appraisers. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. These routine adjustments are made to adjust the value of a specific property relative to comparable properties for variations in qualities such as location, size, and income production capacity relative to the subject property of the appraisal. Such adjustments are typically significant and result in a Level 3 classification of the inputs for determining fair value.

OREO: OREO is measured at fair value less cost to sell, based on an appraisal conducted by a licensed appraiser using observable market data (Level 2). However, if the real estate is a house or building in the process of construction, has an appraised value based on a liquidation or quick sale, is discounted by the Company because of marketability or is based on an appraisal of the real estate property that is over one (1) year old, the fair value is considered Level 3. The estimated fair value is reviewed periodically by management and any write-downs are charged against current earnings. The Company believes that the fair value component in the valuation of OREO follows the provisions of accounting standards. There was no OREO held as of December 31, 2023, or 2022.

There were no transfers between Level 1 and Level 2 during the years ended December 31, 2023 or 2022. The following table summarizes the Company's financial assets that were measured at fair value on a nonrecurring basis as of December 31 (in thousands):

	Fair Value Measures at December 31 using			
	Balance as of December 31,	Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
2023				
Assets:				
Individually evaluated loans, net	$ 385	$ -	$ -	$ 385
2022				
Assets:				
Impaired loans, net	$ 61	$ -	$ -	$ 61

The significant unobservable inputs for the financial asset categories that are measured for fair value are listed above. Significant increases (decreases) in any of those inputs in isolation would result in a significantly lower (higher) fair value measurement. Generally, a change in the assumption used for the probability of default is accompanied by a directionally similar change in the assumption used for the loss severity and a directionally opposite change in the assumption used for prepayment rates. In addition, a change to the selling cost or the discount for lack of marketability and age of appraisal are directly related to the Company's real estate market. An upward movement in the assumptions would result in a decrease in the fair value while a downward movement in assumptions would result in an increase in the fair value.

The following table presents qualitative information about Level 3 fair value measures for financial assets measured at fair value on a nonrecurring basis at December 31, 2023 and 2022 (in thousands):

2023	**Fair Value**	**Valuation Techniques**	**Unobservable Inputs**	**Range**
Assets:				
Individually evaluated loans, net	$ 385	Discounted appraised value/ Discounted cash flows	Selling costs	8-13%
			Discount for lack of marketability and/ or age of appraisal	20-35%
			Discount rate	7.32%

2022	**Fair Value**	**Valuation Techniques**	**Unobservable Inputs**	**Range**
Assets:				
Impaired loans, net	$ 61	Discounted appraised value	Discount for lack of marketability and/ or age of appraisal	10-100%

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

Note 18. Stock Incentive Plan

The 2018 Stock Incentive Plan (the "2018 Plan") was approved by the Company's shareholders at the 2018 Annual Meeting of Shareholders. The 2018 Plan is designed to promote the interests of the Company and its shareholders by strengthening the Company's ability to attract, motivate and retain employees, directors and consultants upon whose judgment, initiative, and efforts the financial success and growth of the business of the Company largely depend. A total of 340,000 shares of common stock are reserved for issuance under the 2018 Plan. The following types of awards will be available for issuance under the 2018 Plan:

- nonstatutory and incentive stock options;
- restricted stock and other stock awards;
- restricted stock units; and
- incentive awards.

A summary of the activity in the 2018 Plan for the year ended December 31, 2023 is as follows:

	Shares	Weighted Average Grant Date Fair Value	Weighted Average Remaining Contractual Term in Years
Unvested restricted stock outstanding			
at December 31, 2022	27,830	$ 11.58	1.51
Granted	27,530	9.33	
Vested	(12,566)	11.80	
Forfeited	(16,232)	10.50	
Unvested restricted stock outstanding			
at December 31, 2023	26,562	$ 9.79	1.76

Restricted stock compensation expense of $103 thousand and $146 thousand was recognized in the years ended December 31, 2023, and 2022, respectively. Total unrecognized stock compensation expense related to restricted stock awards at December 31, 2023 was approximately $159 thousand.

Note 19. Revenue Recognition

On January 1, 2018, the Company adopted FASB ASU 2014-09, *"Revenue from Contracts with Customers (Topic 606)"*, and all subsequent ASUs that modified Topic 606. The implementation of the new standard did not have a material impact on the measurement or recognition of revenue; as such, a cumulative effect adjustment to opening retained earnings was not deemed necessary. Topic 606 does not apply to revenue associated with financial instruments, including revenue from loans and investment securities. In addition, certain noninterest income streams such as fees associated with mortgage servicing rights, financial guarantees, derivatives, and certain credit card fees are also not in scope of the new guidance. Topic 606 is applicable to noninterest revenue streams such as deposit related fees, interchange fees, merchant income, and brokerage fees and commissions. However, the recognition of these revenue streams did not change significantly upon adoption of Topic 606. Substantially all of the Company's revenue is generated from contracts with customers.

Service charges on deposit accounts

The Company earns fees from its deposit customers for transaction-based, account maintenance, and overdraft services. Transaction-based fees, which include services such as stop payment charges, statement rendering, and ACH fees, are recognized at the time the transaction is executed as that is the point in time the Company fulfills the customer's request. Account maintenance fees, which relate primarily to monthly maintenance, are earned over the course of a month, representing the period over which the Company satisfies the performance obligation.

Overdraft fees are recognized at the point in time that the overdraft occurs. Service charges on deposits are withdrawn from the customer's account balance.

Interchange and ATM fees

The Company earns interchange and ATM fees from debit/credit cardholder transactions conducted through the Visa and ATM payment networks. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder. Because the Company acts as an agent and does not control the services rendered to the customers', related costs are netted against the fee income. These costs were included in other operating expenses prior to the adoption of Topic 606.

Brokerage fees and commissions

Brokerage fees and commissions consist of other recurring revenue streams such as commissions from sales of mutual funds and other investments to customers by a third-party service provider and investment advisor fees. The Company receives commissions from the third-party service provider on a monthly basis based upon customer activity for the month. The investment advisor fees are charged to the customer's account in advance on the first month of the quarter, and the revenue is recognized over the following three-month period.

The following table presents noninterest income, segregated by revenue streams in-scope and out-of-scope of Topic 606, for the years ended December 31, 2023 and 2022 (in thousands):

	2023	2022
Noninterest Income		
In-scope of Topic 606:		
Service charges on deposit accounts	$ 683	$ 776
Interchange and ATM fees	1,254	1,270
Brokerage fees and commissions	90	38
Noninterest income in-scope of Topic 606:	2,027	2,084
Noninterest income out-of-scope of Topic 606:	1,480	1,483
Total noninterest income	$ 3,507	$ 3,567

Note 20. Leases

The right-of-use asset and lease liability are included in "Other assets" and "Accrued expenses and other liabilities", respectively, on the Company's consolidated balance sheets. Lease liabilities represent the Company's obligation to make lease payments and are presented at each reporting date as the net present value of the remaining contractual cash flows. Cash flows are discounted at the Company's incremental borrowing rate in effect at the commencement date of the lease. The Company's long-term lease agreements are classified as operating leases. Certain of these leases offer the option to extend the lease term and the Company has included such extensions in its calculation of the lease liabilities to the extent the options are reasonably assured of being exercised.

In the fourth quarter of 2021, the Company executed a sale-leaseback on its corporate headquarters building. The Company recognized a $320 thousand gain on the sale and entered into a five-year lease with an option to renew after the initial five years. Cash paid for amounts included in the measurement of lease liabilities for the years ended December 31, 2023, and 2022 was $356 thousand and $300 thousand, respectively. Total operating lease costs for the years ended December 31, 2023 and 2022 were $41 thousand and $63 thousand, respectively.

	As of December 31,	
	2023	**2022**
(dollars in thousands)		
Lease liabilities	$ 1,083	$ 1,450
Right-of-use assets	$ 1,072	$ 1,442
Weighted average remaining lease term - operating leases (in months)	36	48
Weighted average discount rate – operating leases	1.96%	1.98%

As of December 31, 2023, all of the Company's lease obligations are classified as operating leases. A maturity analysis of operating lease liabilities and reconciliation of the undiscounted cash flows to the total of operating lease liabilities as of December 31, 2023 is as follows (in thousands):

2024	$ 369
2025	380
2026	341
2027	26
Thereafter	-
Total undiscounted cash flows	$ 1,116
Discount	(33)
Lease liabilities	$ 1,083

Note 21. Parent Company Financial Information

Condensed financial information of Touchstone Bankshares, Inc. is presented as follows (in thousands, except shares and per share data):

Condensed Balance Sheets
December 31, 2023 and 2022

	2023	2022
Assets		
Cash and due from Banks	$ 6,665	$ 9,848
Investment in subsidiary bank	56,280	51,332
Other assets	998	482
Total assets	$ 63,943	$ 61,662
Liabilities		
Subordinated debt, net of issuance costs	$ 17,731	$ 17,621
Accrued expenses and other liabilities	1,403	1,394
Total liabilities	19,134	19,015
Shareholders' Equity		
Preferred stock, $2 par value, authorized 500,000 shares; issued and outstanding 29,148 in 2023 and 2022	58	58
Common stock, $2 par value, authorized 10,000,000 shares; issued and outstanding 3,270,676 in 2023 and 3,246,236 in 2022 (includes 26,562 and 27,830 of unvested shares in 2023 and 2022, respectively)	6,541	6,493
Surplus	20,058	19,884
Retained earnings	27,720	27,187
Accumulated other comprehensive loss, net	(9,568)	(10,975)
Total shareholders' equity	44,809	42,647
Total liabilities and shareholders' equity	$ 63,943	$ 61,662

Condensed Statements of Income
For the Years Ended
December 31, 2023 and 2022

	2023	2022
Income		
Dividends from subsidiary bank	$ -	$ 1,000
Expenses		
Interest on borrowed funds	1,011	977
Other expenses	214	239
Total expenses	1,225	1,216
Income tax benefit	273	256
Equity in undistributed net income of subsidiary bank	2,560	4,010
Net income	$ 1,608	$ 4,050

Condensed Statements of Cash Flows
For the Years Ended
December 31, 2023 and 2022

	2023	2022
Cash Flows from Operating Activities		
Net income	$ 1,608	$ 4,050
Adjustments to reconcile net income to net cash used in operating activities:		
Equity in undistributed net income of subsidiary bank	(2,560)	(5,010)
Other, net	(183)	82
Net cash used in operating activities	(1,135)	(878)
Cash Flows from Investing Activities		
Investment in subsidiary bank	(1,000)	(2,000)
Dividends from subsidiary bank	-	1,000
Net cash used in investing activities	(1,000)	(1,000)
Cash Flows from Financing Activities		
Proceeds from issuance of subordinated debt, net of issuance costs	-	9,690
Repurchases of common stock	-	(596)
Dividends paid	(1,048)	(988)
Net cash (used in) provided by financing activities	(1,048)	8,106
Net (decrease) increase in cash and cash equivalents	(3,183)	6,228
Cash and cash equivalents - beginning of year	9,848	3,620
Cash and cash equivalents - end of year	$ 6,665	$ 9,848

Note 22. Subsequent Events

The Company evaluates subsequent events that occur after the balance sheet date but before the financial statements are issued. Recognized subsequent events are those which provide additional evidence about conditions that existed at the date of the balance sheet, including estimates inherent in the preparation of the statements. Recognized subsequent events require adjustment of the financial statements retroactive to the balance sheet date. Non-recognized subsequent events provide evidence of conditions that did not exist at the balance sheet date and require no retroactive adjustment to the financial statements. A material non-recognized subsequent event would be disclosed, but not recognized until the period when the event occurred. Subsequent events for potential recognition and/or disclosure have been considered through April 29, 2024, the date the financial statements were available to be issued.

On February 29, 2024, the Bank entered into a “Third Amendment to Deed of Ground Lease Agreement” with Courthouse Landing VA, LLC, a Florida limited liability company. The Bank intends to purchase a developed lot and plans to construct a branch building of approximately 2,500 – 4,000 square feet on the demised premise. The extension deadline to submit the Bank’s plans and exercise the purchase option expires April 30, 2024.

On March 25, 2024, the Company and First National Corporation (“First National”), the parent holding company for First Bank, entered into an Agreement and Plan of Merger (the “Agreement”), which provides that, subject to the terms and conditions set forth in the Agreement, the Company will merge with and into First National (the “Merger”) with First National being the surviving corporation in the Merger. In addition, simultaneously with or immediately following the Merger of the Company with and into First National, the Bank will be merged with and into First Bank.

The boards of directors of the Company and First National have unanimously approved the Agreement. The Agreement and the transactions contemplated thereby are subject to the approval of the respective shareholders of the Company and First National, regulatory approvals, and other customary closing conditions. Pursuant to the Agreement, three directors of the Company will be (i) invited to serve on the boards of directors of First National and First Bank and (ii) nominated and recommended by First National for reelection at the first annual meeting of First National shareholders following the closing of the Merger.

Subject to the terms and conditions of the Agreement, the Company’s shareholders, including the holders of shares of both the common stock and preferred stock (on an as-converted, one-for-one basis, which shares of preferred stock convert automatically to common stock at the effective time of the Merger) (collectively, “Company Stock”), will receive 0.8122 shares of First National common stock for each share of Company Stock (the “Merger Consideration”). Cash will also be paid in lieu of fractional shares.

Additionally, in connection with the Merger, subject to the terms and conditions of the Agreement, all restricted stock awards of the Company that are unvested and remain outstanding at the effective time of the Merger (with any performance-based vesting deemed to have been achieved) will be cancelled and converted into the right to receive the Merger Consideration.